

# IFRS News

Shedding light on the IASB's activities\*

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## In this issue...

- 1 **Issue of the month**  
IFRS 7 – frequently asked questions
- 2 **IASB/FASB Roadmap**  
Ian Wright on IASB and FASB convergence plans
- 4 **Mining**  
IFRS challenges facing entities in this sector
- 5 **PwC's Global ACS meeting**
- 7 **IASB & IFRIC update**

## Issue of the month

### IFRS 7 – frequently asked questions

The IASB published IFRS 7, *Financial Instruments: Disclosures*, in August 2005. It applies to all companies and provides the market with more information about an entity's financial assets and liabilities, and their associated risks. IFRS 7 replaces the IAS 30 requirements (disclosure requirements for banks and similar financial institutions) and the IAS 32 disclosure requirements.

The standard is effective for accounting periods starting on or after 1 January 2007. Full comparative figures are required. The IFRS 7 disclosures, especially those related to risk will require considerable resources to develop and draft. Management should therefore begin to consider the issues prior to the standard's effective date of 1 January 2007.

The supplement to this month's edition of IFRS News addresses the commonly-asked questions that have arisen to date from the application of this standard.

For further information on applying IFRS 7, see *IFRS News*, December 2005

## 'IFRS 2006' conference in France

Around 900 CEOs, CFOs, financial controllers, finance directors, auditors and others involved in the preparation of IFRS financial statements will be updated on regulatory, technical, operational and strategic issues at PricewaterhouseCoopers' annual IFRS conference in Paris on 16 October, the largest IFRS conference in France.

This year's event will cover:

- Lessons learned from preparing the first IFRS financial statements
- Guidance applicable for the first time in 2006
- Impact of current projects at the IASB and IFRIC
- Questions expected in preparing year-end December 2006 financial statements
- Experiences of implementing the standards from major players at French, European and international levels
- 300 Q&As and video interviews of key figures in IFRS.

Speakers include IASB chairman Sir David Tweedie; PwC partner and IFRIC member, Ian Wright; PwC partner, SEC-FPI, Wayne Carnall; ARC and French Treasury director Jerome Haas; chief accountant of French Securities Exchange Commission and CESR-Fin member Philippe Danjou; president of the French standard setter Antoine Bracchi; FRRP deputy chairman, Ian Brindle; PwC Europe, UK, US and France IFRS leaders Jochen Pape, Peter Holgate, Dave Kaplan and Claude Lopater, respectively; representatives of CAC 40 preparers; and PwC global CEO Sam DiPiazza as IASCF Trustee.

Look out for highlights of this coverage in future editions of IFRS News. For more information about the conference, contact Isabelle Grauer-Gaynor at [fr.pwc.com](mailto:fr.pwc.com).

# Will the FASB and IASB remain divided by a common language?



PwC's IFRS leader Ian Wright looks at progress with the FASB/IASB Roadmap for convergence.

Will the US Securities and Exchange Commission drop its accounting reconciliation requirement for financial statements prepared under IFRS? The removal of this requirement has been talked about for a decade or more but never seems to get much closer. The FASB and IASB frameworks are broadly comparable in their principles. However, despite the programme to converge the two frameworks – the 'Roadmap' – numerous reconciling differences remain. Many reconciling items arise from details of the standards that are chiefly understood by technical experts.

Don Nicolaisen, then Chief Accountant of the SEC, published an article in 2005 that was seen as the first public commitment to a timetable. The target date was 2009 to decide on the minimum changes necessary to align US GAAP and IFRS sufficiently to eliminate the reconciliation requirements. This was a commitment to a date in writing, although it was accompanied by the usual SEC staff disclaimer that the article reflected only the views of the individual. However, most observers believed that the article meant that agreement between the FASB, IASB and the regulators was effectively in place.

The gossip in accounting circles during 2005 showed that the idea of sufficient, rather than absolute, convergence between US GAAP and IFRS was alive and well. Behind-the-scenes negotiations must have been taking place in European and American political circles over what minimum changes would be necessary in order to declare 'victory'. Outside the US, 'victory' would be acceptance of IFRS with no reconciliation to US GAAP. Within the US, 'victory' would be European Commission acceptance of US GAAP's equivalence to IFRS. This would enable concessions to be given so that US domestic companies would not have to reconcile or produce IFRS financial statements to satisfy pan-European capital market legislation contained in new

"I am hopeful that the results of our review of foreign private issuer filings for the year 2005 will give us sufficient information to enable us to recommend an accelerated path to elimination of this reconciliation requirement. ...It is the result of that work and the experience and confidence we gain as to the consistent application of IFRSs that will be critical to determining the speed of our journey..."

"We plan to begin our review of 2005 annual filings using IFRSs in earnest in the second half of 2006 ... Application of IFRSs in a manner that is faithful to the standards and consistent across companies will help expedite the SEC staff's decision to recommend to the Commission the elimination of the required reconciliation from IFRSs to US GAAP."

*Donald Nicolaisen, Northwestern University Journal of International Law and Business, April 2005.*

| To be examined                     | To be examined by the IASB         |
|------------------------------------|------------------------------------|
| Fair value option*                 | Borrowing costs                    |
| Impairment (jointly with the IASB) | Impairment (jointly with the FASB) |
| Income tax (jointly with the IASB) | Income tax (jointly with the FASB) |
| Investment properties**            | Government grants                  |
| Research and development           | Joint ventures                     |
| Subsequent events                  | Segment reporting                  |

\* On the active agenda at 1 July 2005  
\*\* To be considered by the FASB as part of the fair value option project

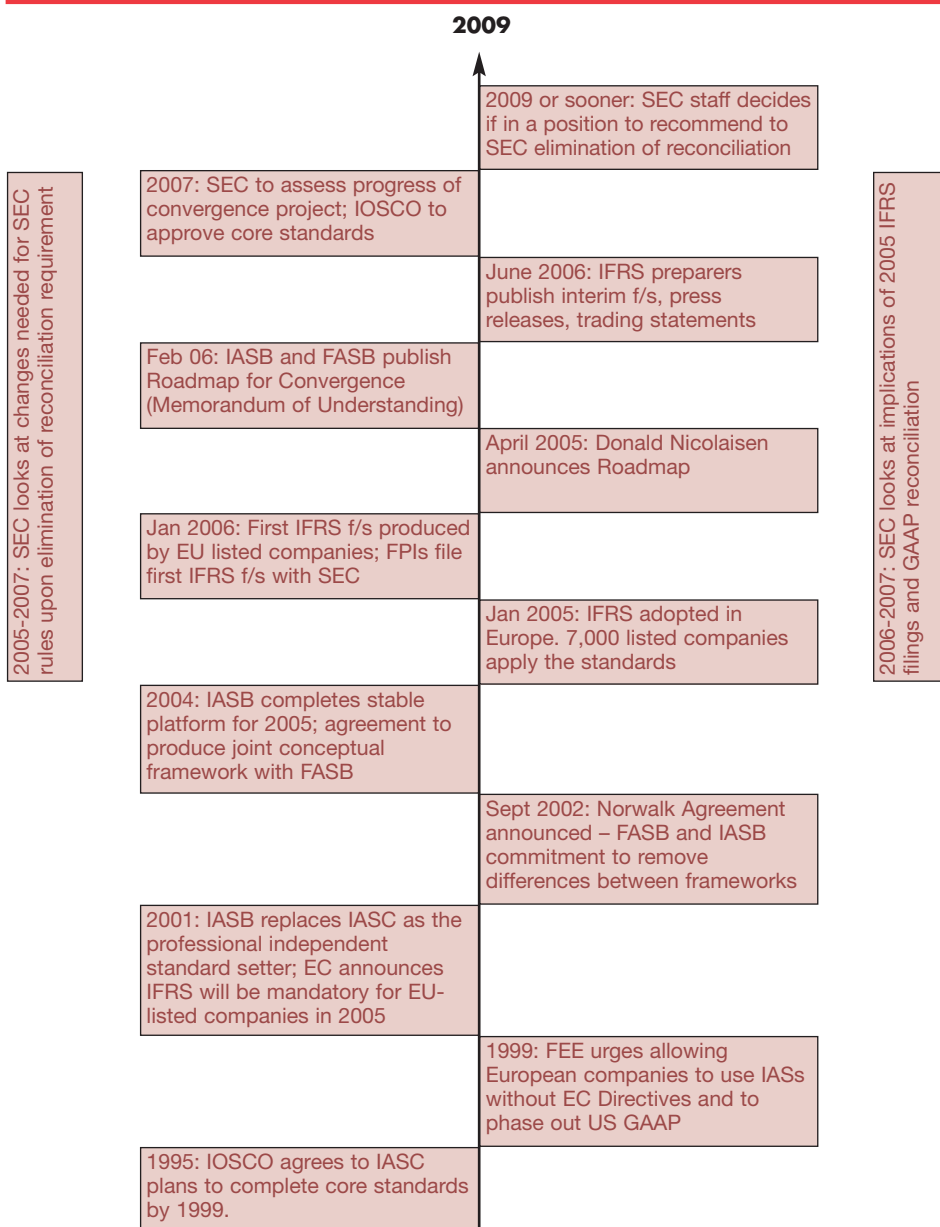
Other joint projects on the boards' agendas are:

| Topic  | 2008 objective                                       |
|--|--|
| <b>Active agenda</b>                                 |  |
| Business combinations                                | Issued converged standards                           |
| Consolidations                                       | Implement work to converge standards                 |
| Fair value measurement guidance                      | Issued converged guidance                            |
| Liabilities and equity distinctions                  | Issued due process documents*                        |
| Performance reporting                                | Issued due process documents*                        |
| Post-retirement benefits                             | Issued due process documents*                        |
| Revenue recognition                                  | Issued due process documents*                        |
| <b>Research projects</b>                             |  |
| Derecognition  | Issued a due process document*                       |
| Financial instruments (replacing existing standards) | Issued due process documents*                        |
| Intangible assets                                    | Decision about scope and timing of potential project |
| Leases   | Decision about scope and timing of potential project |

\* These are exposure drafts and/or discussion papers.

Prospectus and Transparency Directives. Many US domestic companies raise debt in European markets even if their shares aren't listed in the Europe. This behind-

the-scenes activity was heralded as a success in February 2006 with the publication of the 'Memorandum of Understanding' (MoU) between the IASB



and FASB (in effect endorsed by the EC and SEC).

### Convergence agenda items

The goal is to reach a conclusion by 2008. Can major differences in a few focused areas (listed below) be eliminated through one or more short-term standard-setting projects? If so, can the boards complete or substantially complete work in those areas by 2008? The short-term convergence requirements were surprisingly brief.

The agreement between the boards, however, is to consider the topics outlined in the table; it is not a commitment to converge. The decision

on some of these items could be that convergence is not possible. The list is not necessarily, therefore, as formidable as it seems.

A year and a half has gone by since Nicolaisen's speech. What is the progress with the six topics that the IASB has to deliver by the end of 2008 – 15 months from now? Progress looks a bit patchy. Below are some highlights.

### Segment reporting

The IASB exposure draft was issued early this year, and the IASB is in the process of analysing comments. There seems to be strong support in some areas for the US GAAP approach, which requires segments

to be reported based on the data used by management to manage the business. This project seems on track.

### Borrowing costs

The Board published an exposure draft of a revised IAS 23 in July that deals with the capitalisation of borrowing costs. Comments were due by 29 September. Some respondents have said that the Board could have done more to justify its proposals from first principles rather than remove the expensing option in order to achieve convergence. PwC has suggested that the IASB ask the EC and SEC whether this topic is a priority for the 2009 deadline.

### Income tax

There were expectations that the IASB would issue an exposure draft of revisions to IAS 12 in Q2 this year. However, the FASB has been working on amendments to its own standard, so the release of the ED has been delayed. We now expect it before the end of 2006. This makes timing tight for a standard before the end of 2007. Constituents are keen to see deferred tax assets discounted. This is believed to better recognise the economics and underlying uncertainties involved. However, it is unlikely that this will be included in the project.

### Impairment, government grants and joint ventures

Reports on IASB meetings suggest that at least the last two of these topics are fairly close to being published as exposure drafts. However, if the Board is to achieve its target of 31 December 2008, it needs to drop or defer other projects.

What will happen if the IASB and/or FASB miss the Roadmap deadline? We may find out how flexible the EC and SEC are willing to be. Will they take into account progress achieved? Hopefully they are committed to the principle of mutual recognition provided good progress has been made. For the rest of us, we have to deliver on those other areas the SEC and EC have highlighted: consistent-quality application of IFRS, high-quality audits and effective enforcement.

# IFRS challenges facing the mining sector



IFRS poses a number of challenges to companies in the mining sector. Brian Taylor, leader of PwC's mining practice in the UK, explains some of these below.

The mining industry is characterised by a need for large up-front investment with low success rates on exploration spending and long lead-times on new projects. It also faces significant back-end costs when mines are closed, in decommissioning the processing facilities, rehabilitating the sites, dealing with residual environmental issues and managing obligations to the workforce and local communities. There are also many activities in mining that result in saleable production during the development phase as well as contribute to the development of the mine, and hence deliver longer term benefits as well.

Some of the challenges in applying IFRS arise from these industry-specific circumstances. We explore a few below.

## Reserves and resources

Management of mining companies needs to make a key judgment as to whether accounting measures such as depreciation and amortisation should reflect resources that have not yet been classified as reserves. Most entities only take account of proved and probable reserves because they believe there is too much uncertainty about non-reserve material. However, there are several mining companies in the sector (such as Rio Tinto) that do take account of non-reserve material in calculating depreciation and amortisation charges for some mines.

One factor that may affect this decision is where mining companies delay the additional work required to convert resources into reserves without impacting on the current mining plan. It is arguable in such cases that depreciation charges should reflect the expected life of the mine, not the timing of the work required to prove up the reserves.

There is no global standard for determining reserves and resources (even

though there may be local listing requirements relating to disclosure of reserves and, in some cases, resources). Management should exercise caution when taking account of non-reserve material. They need to be able to demonstrate a high degree of confidence that the resources will be converted into reserves and ensure that they apply a consistent policy across all mines.

## Deferred stripping

Should stripping costs that fluctuate during the production stage of a mine be treated as a current-period production cost, or should the excess stripping costs be attributed to future production and carried forward as an asset? This is an example of an activity that contributes both to current production and the development of the mine. There is no clear guidance on how to account for stripping costs under IFRS. Practice therefore varies.

Many companies – including Anglo American, BHP Billiton and Rio Tinto – recognise 'deferred stripping' as an asset; some mining companies do not defer production-stage stripping costs. In addition, various different methods have evolved within the industry to calculate the amounts to defer.

US GAAP has recently changed to prohibit deferral of production-stage stripping costs on the balance sheet. The IASB's Extractive Industries project is many years away from becoming a final standard, but companies should be aware that there is a possibility the IASB will move towards US GAAP requirements in this area.

## Commissioning of new operations

How should management account for the revenues and costs incurred during the commissioning period of a mine?

IFRS assumes that expenditure and revenues can be attributed to a specific purpose. Mining companies are expected to separate those costs that are directly attributable to enhancing the operating capability of a mining asset from those that represent the cost of producing saleable material. This can be a difficult judgment. In commissioning a new block-caving mine, for example, the production rate generally increases as the cave goes higher. This is another example of expenditure being incurred that generates saleable production and forms an essential part of the development of the mine.

## Decommissioning and restoration

Entities are required to provide in full for the decommissioning and restoration costs that arise from the entity's past activities (ie, based on the current condition of the mine). However, it can be difficult for mining companies to distinguish between decommissioning obligations that arise from production and those attributable to mine development. This affects whether the decommissioning obligations should be treated as a production cost or capitalised (as part of the cost of an asset).

## Long-term stockpiles

Lower grade material may be stockpiled during the early stages of the mining operation in the expectation that it will not be processed for many years to come. The costs associated with such material should be considered for deferral (as non-current inventory) if the ore can be processed economically and there is an intention to process it. This decision may, however, depend on whether management assesses economic viability using current market prices or those expected to prevail in the future (when the material is processed).

IFRS does not address the calculation of net realisable value for inventory that may not be processed for many years. One issue that arises, for example, is whether the future cash flows should be discounted. There is no requirement under IFRS to apply discounting, but there is a strong conceptual support for it, as the time value of money is normally applied in establishing values for other non-current assets.

### Impairment

A mining company that is faced with a potential impairment issue is required under IAS 36 to calculate the impairment using the higher of value in use and fair value less costs to sell. Value-in-use calculations are based on projected future cash flows. However, IFRS requires any future cash flows in a foreign currency to be translated at year-end exchange rates – even though these exchange rates might be inconsistent with the company's commodity price assumptions. IFRS also restricts the extent to which the projected cash flows can reflect future capital expenditure and planned cost savings.

These and other difficulties mean that mining companies may not regard value-in-use calculations as providing an appropriate basis for determining impairments. IFRS guidance is brief when describing how the alternative of fair value

less costs to sell should be applied. This can make the evaluation of impairments difficult, as the market-based data from recent relevant transactions may not be available.

### Financial instruments

The IAS 39 requirements on accounting for financial instruments and derivatives can be difficult to apply. The complex qualifying criteria for adopting hedge accounting are especially challenging; this can mean that many instruments viewed by management as providing an economic hedge are treated as speculative under IAS 39.

A variety of contracts in the mining sector may meet the definition of a derivative and need to be accounted for at fair value, including derivatives that reside within a non-derivative host contract (embedded derivatives). For example, a contract entered into by an Australian mining company to purchase equipment from a Japanese supplier in US dollars effectively contains an Australian dollar: US dollar forward contract. This may need to be separated from the host contract and accounted for at fair value under IAS 39.

There is concern in the industry that the application of IAS 39 provides a one-sided view of the world. This is because changes in the value of derivatives are reflected in the financial statements immediately, but

any offsetting changes in the value of the ore reserves are not recognised until the material is extracted and sold. The IASB is considering whether reserves (and potentially resources) should also be accounted for at fair value, which would address this concern. However, the view across the industry seems to be that there is too much judgment surrounding the valuation of reserves for this to provide meaningful or consistent financial reporting.

### Industry-specific guidance in sight?

IFRS requirements are difficult to apply to some areas of the mining sector and mining companies have struggled to find a consistent approach. There is no specific guidance for mining activities except for IFRS 6, Exploration for and Evaluation of Mineral Resources.

The IASB has formed an Extractive Activities working group, so we can expect formal guidance in respect of many of the issues highlighted in due course. However, this guidance is not expected for a number of years.

*These and further examples of challenges facing companies applying IFRS in the mining sector are provided in Real Time – IFRS in the mining sector. Electronic copies are available for download from [www.pwc.com/mining](http://www.pwc.com/mining). Hard copies are available from [olesya.hatop@de.pwc.com](mailto:olesya.hatop@de.pwc.com)*

## PwC's Global Accounting Consulting Services advances global approach



Next month sees the annual meeting of the partners in PricewaterhouseCoopers' Global Accounting Consulting Services team. The 60 partners from all over the world will be gathering in London to discuss the latest IFRS developments and share knowledge and experiences.

"This is a great opportunity to meet face to face for the team of partners who

usually communicate by email and telephone", says John Brendon, PwC's global leader of accounting services, "and to find out about the trends and developments taking place in different countries. I expect the partners to build strongly on the relationships that have already been established in Global ACS and to go away with a reinforced view of how we can give the best advice on

IFRS globally. They should feel inspired about how to leverage from the experiences of others for the benefit of our clients and engagement teams."

Global ACS was established to organise the delivery of consistent-quality IFRS advice and tools for the PwC network of firms.

## IASB project timetable

| Project   | ED published/expected  | Comment deadline                                   | Standard published/expected |
|---|--|--|-----------------------------|
| <b>Business combinations and related issues (FASB and IASB joint project)</b>                       |  |  |                             |
| – IFRS 3, Phase 2: application of purchase method   | 12 July 2005   | 28 October 2005<br>Roundtables planned<br>Q4, 2006 | Some time in 2007           |
| – Minority interests: amendment to IAS 27   | 12 July 2005   | 28 October 2005                                    | Some time in 2007           |
| <b>Convergence</b>  |  |  |                             |
| – IAS 37  | 12 July 2005   | 28 October 2005                                    | Undecided                   |
| – IAS 12, Income Taxes  | Q4, 2006   | Undecided  | Some time in 2008           |
| – Amendment to IAS 20, Government Grants  | Deferred until IAS 37 finalised                                | Undecided  | Undecided                   |
| – IAS 14, Segment Reporting (IFRS 8)  | 19 January 2006  | 19 May 2006  | Q4 2006/Q1 2007             |
| – IAS 23, Borrowing Costs   | 25 May 2006  | 29 September 2006                                  | Q1 or Q2, 2007              |
| – IAS 31, Interests in Joint Ventures   | Q2, 2007   | Undecided  | Some time in 2008           |
| – Amendment to IAS 33, Earnings per share   | Q4, 2006   | Undecided  | Q3 or Q4, 2007              |
| – Impairment  | Active project   | Undecided  | Undecided                   |
| <b>IAS 32 – Financial Instruments Puttable at Fair Value and Obligations arising on Liquidation</b> | 22 June 2006   | 23 October 2006                                    | Q1 or Q2, 2007              |
| <b>Amendment to IAS 24, Related Party Disclosures</b>   | Q4, 2006   | Undecided  | Undecided                   |
| <b>Fair value measurement guidance</b>  | Discussion paper expected Q4, 2006. ED expected Q3 or Q4, 2007 | Undecided  | Some time in 2008           |
| <b>IFRS 2 amendments – vesting conditions and cancellations</b>                                     | 2 February 2006  | 2 June 2006  | Q4, 2006/Q1, 2007           |
| <b>Consolidation (including SPEs)</b>   | Q1 or Q2, 2007   | Undecided  | Some time in 2008           |
| <b>Reporting comprehensive income</b>   |  |  |                             |
| – Segment A   | 16 March 2006  | 17 July 2006                                       | Q1, 2007                    |
| – Segment B   | Discussion paper due Q1, 2007                                  | Undecided  | Undecided                   |
| <b>Revenue and related liabilities (FASB and IASB joint project)</b>                                |  |  |                             |
| <b>Emission rights</b>  | Undecided<br>(depends on IAS 20)                               | Undecided  | Undecided                   |
| <b>Standards for Non-Publicly Accountable Entities (formerly: SMEs)</b>                             |  |  |                             |
| <b>IFRS 4, Insurance Contracts: Phase 2</b>   | Discussion paper Q1, 2007; ED expected 2008                    | Undecided  | Undecided                   |
| <b>Leases – joint project with UK ASB</b>   | Undecided  | Undecided  | Undecided                   |

Note: these dates are provisional only and subject to change

## IFRIC project timetable

| Project   | ED published/expected | Comment deadline  | Standard published/expected                                |
|---|-----------------------|-------------------|--|
| <b>Interpretations issued this year</b>   |                       |                   |  |
| IFRIC 8, Scope of IFRS 2  | May 2005              | 18 July 2005      | 12 January 2006  |
| IFRIC 9, Reassessment of Embedded Derivatives (IFRIC 9)   | 1 April 2005          | 31 May 2005       | 1 March 2006   |
| IFRIC 10, Interim Financial Reporting and Impairment  | 12 January 2006       | 31 March 2006     | 20 July 2006   |
| <b>Drafts under discussion</b>  |                       |                   |  |
| D9, Employee Benefit Plans with Promised Return on Contributions or Promised Contributions          | 8 July 2004           | 21 September 2004 | Undecided  |
| D11, Changes in Contributions to Employee Share Purchase Plans                                      | 16 December 2004      | 1 March 2005      | Closed June 2005. Issues to be covered in IFRS 2 amendment |
| D12, Service Concession Arrangements – Determining the Accounting Model                             | 3 March 2005          | 31 May 2005       | Q4, 2006   |
| D13, Service Concession Arrangements – the Financial Asset Model                                    | 3 March 2005          | 31 May 2005       | Q4, 2006   |
| D14, Service Concession Arrangements – the Intangible Asset Model                                   | 3 March 2005          | 31 May 2005       | Q4, 2006   |
| D17, IFRS 2 – Group and Treasury Share Transaction  | May 2005              | 18 July 2005      | Q4, 2006   |
| D19, IAS 19 – The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements | 24 August 2006        | 31 October 2006   | Undecided  |
| D20, Customer Loyalty Programmes  | 7 September 2006      | 6 November 2006   | Q1, 2007   |
| <b>Note: these dates are provisional only and subject to change</b>                                 |                       |                   |  |

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