# IASB Update

From the International Accounting Standards Board

October 2012

## Welcome to IASB Update

The IASB met in public from 15-19 October 2012 at the IASB offices in London, UK. The FASB joined the IASB for some of the sessions via video from its offices in Norwalk.

The topics for discussion were:

- Insurance Contracts
- Accounting for Macro Hedging
- Classification and Measurement
- Financial Instruments: Impairment
- Revenue Recognition
- IFRIC Update
- Due process papers
- IAS 8 Effective dates and transition methods


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**Future Board meetings**

The IASB meets at least once a month for up to five days.

The next Board meetings in 2012 are:

19-23 November
17-21 December

To see all Board meetings for 2012, **click here**.

**Archive of IASB *Update* Newsletter**

**Click here** for archived copies of past issues of IASB *Update* on the IFRS website.

**Podcast summaries**

To listen to a short Board meeting audio summary (podcast) of previous Board meetings, **click here**.

## Insurance Contracts

**IASB-only education session**

The IASB held an education session to continue its discussions of the proposed Insurance Contracts Standard. The IASB discussed the presentation approach in the statement of comprehensive income for premiums and claims, non-claims fulfilment costs and acquisition costs.

No decisions were made.

**IASB-FASB joint sessions**

The IASB and FASB continued their joint discussions on the Insurance Contracts project where they discussed:

- the time value of money in the premium allocation approach;
- the presentation of changes in the liability for participating contracts; and
- how premiums and claims, non-claims fulfilment costs and acquisition costs should be presented in the statement of comprehensive income.

*Time value of money in the premium allocation approach*

The boards tentatively decided that that the discount rate at inception of the contract should be used to measure the liability for remaining coverage, when it is accreted or discounted.

All IASB members and all FASB members agreed.

The boards discussed how the decision to present in Other Comprehensive Income (OCI) changes in the insurance liability arising from changes in discount rates would apply to the presentation of the liability for incurred claims for contracts to which the premium allocation approach is applied. The boards tentatively decided that when the liability for incurred claims is discounted, an insurer should use the rate at the inception of the contract to determine the amount of the claims and interest expense in profit or loss. That rate is subsequently locked in.

Six FASB members agreed with this decision. Eleven IASB members preferred using the rate on the date the claim is incurred. However, thirteen IASB members agreed to use the rate at the inception of the contract, for the sake of convergence.

*Participating contracts*

The boards considered previous tentative decisions that apply to contracts with participating features for which the mirroring approach would apply. In particular, they noted that the mirroring decision would take precedence over the tentative decision that insurers should present in OCI changes in the insurance contract liability arising from the effect of changes in the discount rate. As a result, for contracts with participating features where the mirroring decision applies, insurers would present changes in the insurance contract liability in the statement of comprehensive income consistently with the presentation of changes in the directly linked underlying items. No decisions were made.

The FASB tentatively decided that, for contracts to which the mirroring decisions do not apply and where the contractual obligation to the policyholder is directly linked to the fair value of the underlying items, changes in the insurance liability should be presented in profit or loss.

All FASB members agreed with this decision.

*Presentation in the statement of comprehensive income*

*Premiums and claims*

The boards tentatively decided that premiums and claims presented in an insurer's statement of comprehensive income should be determined by applying an earned premium presentation, whereby premiums are allocated to periods in proportion to the value of coverage (and any other services) that the insurer has provided in the period, and that claims should be presented when incurred.

Thirteen IASB members and five FASB members agreed with this decision. The FASB also asked the FASB staff when drafting to consider the inclusion of application guidance about other approaches that may meet the earned premium principle, noting that the description of the approach within the Agenda Papers was too prescriptive.

*Non-claims fulfilment costs*

The boards tentatively decided that in an earned premium presentation:

a. The portion of premium allocated to cover non-claims fulfilment costs should be equal to the originally expected non-claims fulfilment costs included in the measure of the building block liability.
b. The premium allocated to cover non-claims fulfilment costs should be included in earned premium in the periods in which the costs are expected to be released from the liability for remaining coverage, ie when it is expected that they will be either incurred or added to the liability for incurred claims.
c. The amounts presented as expenses should be the actual costs incurred or be added to the liability for incurred claims in the period.

Fourteen IASB members and all FASB members agreed with this decision.

*Acquisition costs*

The IASB tentatively decided that the cash flows relating to acquisition costs should be recognised in the statement of comprehensive income over the coverage period. (This decision is consistent with a decision previously made by the FASB.)

Fourteen IASB members agreed with this decision. One IASB member abstained.

The FASB tentatively decided that an insurer should disaggregate in the statement of financial position the insurance contracts liability into the expected cash flows to fulfil the insurance obligation and the margin. Acquisition costs should be reported as part of the margin (ie the margin includes the acquisition costs expected to be paid and is reduced when those acquisition costs are paid).

Five FASB members agreed with this decision.

The boards tentatively decided that acquisition costs should be recognised in the statement of comprehensive income in a way that is consistent with the proposed allocation of the residual/single margin. In other words:

a. For the IASB, in a way that is consistent with the pattern of transfer of services provided under the contract.
b. For the FASB, as the insurer satisfies its performance obligations to stand ready to compensate the policyholder if a specified uncertain future event adversely affects the policyholder, which is when the insurer is released from exposure to risk as evidenced by a reduction in the variability of cash outflows. Consequently, the margin recognised should be grossed up for the amount of acquisition costs recognised.

All IASB members and all FASB members agreed with this decision.

**IASB-only session**

The IASB met to discuss financial instruments with discretionary participation features, transition requirements, effective date, comparative information and early application.

*Financial instruments with discretionary participation features*

The IASB tentatively decided to adapt the contract boundary criteria and recognition criteria for a financial instrument with a discretionary participation feature as follows:

a. The contract boundary for a financial instrument with a discretionary participation feature is the point at which the contract no longer confers substantive rights on the contract holder. A contract no longer confers substantive rights on the contract holder when:
    i. the contract holder no longer has a contractual right to receive benefits arising from the discretionary participation feature in that contract; or
    ii. the premiums charged confer upon the contract holder substantially the same benefits as those that are available, on the same terms, to those that are not yet contract holders.
b. An entity shall recognise a financial instrument with a discretionary participation feature only when the entity becomes a party to the contractual provisions of the instrument, eg when the entity is contractually obliged to deliver cash.

All IASB members present agreed with these decisions. One IASB member was absent from this session.

*Transition requirements*

The IASB made the following tentative decisions related to transition to the proposed new Insurance Contracts Standard:

a. An insurer shall follow the reclassification guidance in IFRS 9 *Financial Instruments* except that an insurer should be:
    i. permitted to designate eligible financial assets under the fair value option where new accounting mismatches are created by the application of the proposed new Insurance Contracts Standard;
    ii. required to revoke previous designations under the fair value option where the accounting mismatch no longer exists because of the application of the proposed new Insurance Contracts Standard;
    iii. following earlier application of IFRS 9, permitted to newly elect to use other comprehensive income for the presentation of changes in the fair value of some or all equity instruments that are not held for trading, or revoke a previous election if applicable.
b. An insurer shall determine the residual margin on transition, assuming that all changes in estimates of cash flows between initial recognition and the beginning of the earliest period presented were already known at initial recognition.

In addition, the IASB tentatively decided that:

a. the proposed transition requirements for insurers that already apply IFRS should also apply to first-time adopters of IFRS; and
b. it would not include explicit guidance on redesignation of property, plant and equipment and investment property on transition.

All IASB members present agreed with these decisions. One IASB member was absent from this session.

*Effective date, comparative financial statements and early application*

The IASB stated its intention to allow approximately three years between the date of publication of the final Insurance Contracts Standard and the mandatory effective date. In addition: the IASB tentatively decided:

a. to permit entities to apply the final Insurance Contracts Standard before the mandatory effective date; and
b. to require entities to restate comparative financial statements on first application of the final Insurance Contracts Standard.

Twelve IASB members present agreed with these decisions. One IASB member was absent from this session.

***Next steps***

The IASB will continue its joint discussions with the FASB on the Insurance Contracts project at their joint meeting in November 2012.

## Accounting for Macro Hedging

The IASB met to continue the discussion on the proposed revaluation model for interest rate portfolio hedging activity. In this meeting they discussed the last of the 11 steps identified at the November 2011 meeting.

*Credit risk and floating leg considerations (Steps 8 and 9)*

The IASB discussed the treatment of changes in fair value of hedging derivatives with respect to credit risk and floating legs within the proposed revaluation model.

It was discussed that under the revaluation model hedging derivatives would remain at Fair Value through Profit or Loss (FVPL), as required by IFRS 9 *Financial Instruments*. Measuring the fair value of derivatives is governed by IFRS 13 *Fair Value Measurement*, which would include fair value fluctuations resulting from changes in derivatives' floating legs and credit risk.

*Treatment of unrecognised items: loan commitments and pipeline trades*

The IASB discussed whether items that are not recognised in the statement of financial position could be integrated into the accounting model for macro hedging on the basis of a net portfolio revaluation approach for interest rate risk. This relates to Steps 2 and 3 of the 11-step overview presented at the November 2011 meeting. The focus of the discussion was on transactions that do not yet exist (eg forecast volumes of products at advertised rates—colloquially referred to as 'pipeline trades').

The IASB considered the following aspects.

1. whether including pipeline trades in the hedged risk position would be consistent with the existing *Conceptual Framework for Financial Reporting* (the Framework) and there was also discussion that the Discussion Paper on accounting for macro hedging would overlap with the discussion of the project on the Framework;
2. the economic and legal boundary between existing and non-existing items; and
3. accounting implications and alternatives when pipeline trades are prohibited from being included in the hedged risk position.

No decisions were made.

***Next steps***

The IASB staff will start to consider the application of the proposed revaluation model to risks other than interest rate risk. The staff will also begin drafting an overview of the revaluation model after consideration of the IASB discussions to date, which could be included in a Discussion Paper on Accounting for Macro Hedging.

## Classification and Measurement

The IASB noted that the IASB staff have received feedback about interest rates in a regulated environment and that they plan to gather more information on the issue through the Exposure Draft process. The Exposure Draft will include the proposed clarification about a modified relationship between principal and the consideration for the time value of money and credit risk, but will not suggest any further proposed amendments to the contractual cash flow characteristics assessment.

This session was for information purposes only. No decisions were made.

## Financial Instruments: Impairment (IASB-only)

*Background*

In July 2012 the IASB and the FASB finished deliberating all joint matters in developing the general framework of a three bucket impairment model. (On completion of developing the impairment model the boards tentatively agreed that it was only necessary to distinguish between assets with a 12-month allowance balance and those with a life time expected loss balance. Thus, the impairment model is now essentially a 'two-bucket model'. However, because of general familiarity with the 'three-bucket' description and because a third stage of deterioration (ie incurred losses) triggers a change in the way in which interest revenue is presented, the IASB staff will continue to use the term 'three-bucket' when discussing the IASB's own proposed impairment model.)

In response to feedback received from US constituents about that model, in August 2012 the FASB directed their staff to explore an alternative expected loss model that:

a. does not use a dual-measurement approach; and
b. reflects all credit risk in the portfolio at each reporting date.

In the last few months the IASB staff have had detailed discussions with investors, analysts, regulators, auditors and preparers to better understand whether the three bucket impairment model would be operational and whether that model or the FASB's alternative model would provide more useful information.

*Current discussions*

At this meeting, the IASB staff presented a summary of the feedback received. Overall the majority of outreach participants, including users of financial statements, support an impairment model that distinguishes assets that have deteriorated in credit quality from those that have not. However, additional clarification was requested for the criteria to be used in determining when a lifetime loss is measured and how to apply the criteria to retail loans. In addition, some participants noted that their support for the approach was dependent on whether the benefits of the

information provided outweighed the costs of determining which assets have deteriorated. In particular, some noted that if assets were to move too readily to a lifetime loss measurement (for example, on the basis of minor credit deterioration) the costs of the model might not be justified. The IASB asked the staff to explore ways to address those concerns and to suggest clarifications to the criteria at a future meeting.

A few participants in the outreach questioned the conceptual merits of the model in the absence of convergence. They would prefer the IASB to reconsider the proposals in the 2011 Supplementary Document *Financial Instruments: Impairment* (but using the Time Proportional Allocation approach without the floor for the good book), or the expected cash flow model in the original IASB Exposure Draft *Financial Instruments: Amortised Cost and Impairment*. While the IASB indicated that they wish to pursue the three-bucket impairment model, they also asked the IASB staff to prepare a paper summarising the feedback on the Supplementary Document as a reminder of why the IASB rejected that approach in favour of the three-bucket impairment model.

***Next steps***

At its November 2012 meeting, the IASB will discuss possible clarifications to the criteria for recognition of lifetime expected losses. A public IASB Education Session on the FASB's alternative model is also planned for November 2012, and will be provided by the FASB.

## Revenue Recognition

The IASB and the FASB (the boards) discussed the following topics as they continued their redeliberations on the revised Exposure Draft, *Revenue from Contracts with Customers* (the 2011 ED):

a. Contract modifications
b. Measuring progress toward complete satisfaction of a performance obligation.

*Contract Modifications*

The boards discussed the application of the proposed contract modifications requirements in the 2011 ED. Specifically, they discussed how those proposals would apply to modifications that current guidance on contracts in IFRSs and US GAAP describe as contract claims in which changes in scope and price are unapproved or in dispute. The boards tentatively decided that an entity should account for those contract claims in accordance with the proposed contract modifications requirements. The boards also tentatively decided to clarify that a contract modification, including a contract claim, would be approved when the modification creates or changes the enforceable rights and obligations of the parties to the contract. The boards noted that, consistently with the proposals on identifying the contract, a contract modification could be approved in writing or orally or the approval could be implied by customary business practice.

The boards also tentatively decided:

a. To require an entity to account for contract modifications that result only in a change to the transaction price in accordance with paragraph 22 of the 2011 ED, which is consistent with the accounting for contract modifications that result in a change in scope. Consequently, the Revenue Standard would not include the proposal in paragraph 20 of the 2011 ED, which would have required a modification that results only in a change to the transaction price to be treated consistently with changes in transaction price (paragraphs 77–80 of the 2011 ED).
b. To clarify that, for modifications within the scope of paragraph 22(a) of the 2011 ED, the transaction price available for allocation to the remaining separate performance obligations should be the amount of

consideration received from the customer but not yet recognised as revenue plus the amount of any remaining consideration that the customer has promised to pay that has not been recognised as revenue.

c. To clarify that, for modifications within the scope of paragraph 22(a) of the 2011 ED and for which there is a subsequent change in the estimate of the transaction price, an entity should account for the modification prospectively unless the change in the transaction price relates to satisfied performance obligations, in which case the entity should account for that change in accordance with the proposed requirements in paragraphs 77–80 of the 2011 ED. A similar approach would apply to accounting for revenue that had previously been constrained.

All IASB and FASB members agreed.

*Measuring Progress toward Complete Satisfaction of a Performance Obligation*

The boards discussed the following topics related to measuring progress toward complete satisfaction of a performance obligation that is satisfied over time:

a. the use of methods such as units produced or units delivered; and
b. adjustments that should be made to input methods, such as costs incurred, in order to meet the objective for measuring progress that is proposed in paragraph 38 of the 2011 ED.

The boards discussed the use of 'units produced' or 'units delivered' as appropriate methods for an entity to use to measure its progress toward complete satisfaction of a performance obligation that is satisfied over time (in accordance with paragraph 35 of the 2011 ED). The boards tentatively decided that methods such as units produced or units delivered could provide a reasonable proxy for the entity's performance in satisfying a performance obligation in the following circumstances:

a. A units produced method could provide a reasonable proxy for the entity's performance if the value of any work in progress at the end of the reporting period is immaterial.
b. A units delivered method could provide a reasonable proxy for the entity's performance if:
    i. the value of any work in progress at the end of the reporting period is immaterial; and
    ii. the value of any units produced but not yet delivered to the customer at the end of the reporting period is immaterial.

Fourteen IASB members of the IASB and five FASB members agreed.

The boards tentatively decided to clarify in the Revenue Standard that the adjustment to the input method (for uninstalled materials) that is proposed in paragraph 46 of the 2011 ED is to ensure that the input method meets the objective of measuring progress that is specified in paragraph 38 of the 2011 ED—that is, to depict the entity's performance. The boards also tentatively decided to refine the fact pattern in Illustrative Example 8 to help clarify the scope of the requirements. In addition, the boards tentatively decided that the Revenue Standard should clarify that if an entity selects an input method such as costs incurred to measure its progress, the entity should make adjustments to that measure of progress if including some of those costs incurred (for example, wasted materials) would distort the entity's performance in the contract.

All IASB and FASB members agreed.

## IFRIC Update

The IASB received an update from the September 2012 meeting of the IFRS Interpretations Committee (the

Interpretations Committee). Details of the meeting were published in *IFRIC Update*, which is available by **clicking here**.

The IASB was informed of a request for guidance on the meaning of 'expiry' within the context of accounting for the derecognition of financial assets. This request had been received as part of the feedback on the Interpretations Committee's discussion of derecognition of financial instruments upon modification, and on which it finalised an agenda decision at its September 2012 meeting. The IASB noted the request.

One IASB member was absent from this session.

## Due process papers

The IASB discussed two forthcoming amendments.

*Equity method of accounting: accounting for the share of other net asset changes (proposed amendments to IAS 28)*

The IASB staff explained the due process steps the IASB has taken to date in preparation for the publication of the Exposure Draft and noted that the applicable due process steps have been completed.

All IASB members present agreed that it has complied with the due process requirements to date.

*Annual Improvements to IFRSs 2011-2013 cycle*

The IASB staff explained the due process steps the IASB has taken to date in preparation for the publication of the Exposure Draft and noted that the applicable due process steps have been completed.

All IASB members present agreed that it has complied with the due process requirements to date.

The IASB members were asked if any of them intended to register dissent on any of the issues proposed for inclusion in the Annual Improvements 2011-2013 cycle. Subject to consensus on the final wording of the proposed amendments, no IASB members intend to dissent.

The IASB discussed the staff recommendation that the IASB should publish the Exposure Draft with a comment period of not less than 120 days. Although the IASB's due process requires only a 90-day comment period for Annual Improvements, the staff were concerned about the potential effect of one of the proposed amendments (proposed amendments to IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* relating to revenue-based depreciation) on one particular industry, and therefore proposed a longer comment period.

The IASB noted the concerns and decided that:

a. the proposed amendments to IAS *16 Property, Plant and Equipment* and IAS 38 *Intangible Assets* relating to revenue-based depreciation should be removed from the Annual Improvements project and be published in a separate Exposure Draft with a comment period of 120 days; and
b. the remaining issues should be exposed in the form of Annual Improvements with a comment period of 90 days.

All IASB members present agreed. One IASB member was absent from this session.

## IAS 8—Effective dates and transition methods

*Background*

In May 2012 the IASB tentatively decided to remove the requirement in paragraph 28 (f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* related to a change in accounting policy that results from a change in an IFRS. Instead, the IASB would decide on a case-by-case basis whether additional disclosures are needed.

During the balloting process, however, the IASB staff identified new matters that they decided should be brought back to the IASB for consideration in a public meeting. In the interim the IASB has agreed to special transition requirements for IFRS 9 *Financial Instruments*, thus making the need for amendments to IAS 8 less urgent.

*Current discussions*

At this meeting the IASB decided to:

a. stop the balloting process for the proposed amendments to IAS 8; and
b. remove the project to make narrow-scope amendments to IAS 8 from the current work plan.

The IASB staff will continue to collect information about how changes in accounting policy are being presented in financial statements. Comparability, which is at the heart of the IAS 8 requirements, will be considered more generally in the development of the presentation and disclosure chapters in the Conceptual Framework project. The more general matters of comparability and transition are also being considered as a topic for an upcoming IASB Disclosure Forum.

It will remain incumbent on the IASB staff to assess and present to the IASB on a case-by-case basis whether to create more specific transition requirements for a particular IFRS or amendment.

One IASB member was absent from this session.

## Work plan as at 19 October 2012

| Next major project milestone | | | | | | |
|---|---|---|---|---|---|---|
| **Agenda consultation** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | **MoU** | **Joint** |
| **Three-yearly public consultation** | Feedback Statement | Development of strategy | | | | |
| Next major project milestone | | | | | | |
| **Financial Crisis-related projects** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | **MoU** | **Joint** |
| **IFRS 9: *Financial Instruments* (replacement of IAS 39)** | | | | | | |

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|---|---|---|---|---|---|---|
| **Classification and Measurement** (limited amendments) | Target ED | | | |  |  |
| **Impairment** | Target ED | | | |  |  |
| **General hedge accounting** [Review Draft posted until December 2012] | Target IFRS | | | |  | |
| **Accounting for macro hedging** | | Target DP | | |  | |
| Next major project milestone | | | | | | |
| **Memorandum of Understanding projects** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | **MoU** | **Joint** |
| **Leases** | | Target ED | | |  |  |
| **Revenue Recognition** | Redeliberations | Target IFRS | | |  |  |
| Next major project milestone | | | | | | |
| **Other Projects** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | **MoU** | **Joint** |
| **Insurance Contracts** | | Target ED | | | |  |
| **Consolidation– Investment entities** | Target IFRS[1] | | | | |  |
| **Narrow scope amendments** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | **MoU** | **Joint** |
| **Annual Improvements 2010-2012** | | | Target completion | | | |
| **Annual Improvements 2011-2013** | Target ED | | | | | |
| Revenue-based methods of depreciation and amortisation (Proposed amendments to IAS 16 and IAS 38) | Target ED | | | | | |
| **Sales or contributions of assets between investor and its associate/ joint venture (Proposed amendments to IFRS 10 and IAS 28)** | Target ED | | | | | |
| Equity method of accounting: accounting for other net asset changes (Proposed amendments to IAS 28) | Target ED | | | | | |
| **Acquisition of an interest in a joint operation (Proposed amendments to IFRS 11)** | Target ED | | | | | |
| [1]Amendment to IFRS 10 *Consolidated Financial Statements* | | | | | | |
| Next major project milestone | | | | | | |
| **Interpretations** | **2013 H1** | **2013 H2** | | | | |
| **Levies Charged by Public Authorities on Entities that Operate in a Specific** | Target Interpretation | | | | | |

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|---|---|---|---|---|---|---|
| **Market** | | | | | | |
| **Put Options Written on Non-controlling Interests** | | Target Interpretation | | | | |
| Next major project milestone | | | | | | |
| **IFRS for SMEs** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | | |
| **Comprehensive Review 2012-2014** [comment period ends 30 November 2012] | See detailed timetable on **project page** | | | | | |
| Next major project milestone | | | | | | |
| **Post-implementation reviews** | **2012 Q4** | **2013 Q1** | **2013 Q2** | **2013 Q3** | **MoU** | **Joint** |
| **IFRS 8 *Operating Segments*** [comment period ends 16 November 2012] | | Consider comments received | | | | |
| ***IFRS 3 Business Combinations*** | | Initiate review | | | | |
| Next major project milestone | | | | | | |
| **Research Projects** | **2013 H1** | **2013 H2** | | | | |
| **Rate-regulated Activities** | | Target DP | | | | |
| **Bearer biological assets (limited-scope project—IAS 41 )** | Target ED | | | | | |
| **Conceptual Framework (chapters addressing elements of financial statements, measurement, reporting entity, and presentation and disclosure)** | Target DP | | | | | |


ISSN 1474-2675