IASB Update

From the International Accounting Standards Board

July 2010

Welcome to IASB Update

This IASB Update is a staff summary of the tentative decisions reached by the Board at a public meeting. As a project progresses, the Board can, and sometimes does, modify its earlier tentative decisions. Tentative decisions do not change existing requirements until those decisions are incorporated in a new or amended standard.

The International Accounting Standards Board met in London on 19 - 23 July 2010. The US Financial Accounting Standards Board (FASB) joined the IASB for some sessions. The topics discussed were:

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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 2010 are:

3 August
24 August
13 - 17 September
18 - 22 October

To see all Board meetings for 2010, **click here**.

Archive of IASB Update Newsletter

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Podcast summaries

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

Amortised cost and impairment

In November 2009 the IASB published the exposure draft *Financial Instruments: Amortised Cost and Impairment* (the ED). The 8-month comment period ended on 30 June 2010. An Expert Advisory Panel (EAP) was set up during the comment period to consider operational issues arising from the Board's proposed approach.

At this meeting, the Board began redeliberations on this phase of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement* and discussed feedback from comment letters and the EAP. The staff presented the main themes identified from the initial review of comment letters in a summary form. A more detailed analysis of particular issues that were identified will be presented at future Board meetings. The staff also presented a summary of feedback on the main issues discussed at the EAP.

No decisions were made by the Board at this session.

Annual improvements

IFRS 1 *First-time Adoption of International Financial Reporting Standards* - Fixed dates in the derecognition exception and in the financial instruments initial measurement exemption

The IASB discussed a recommendation from the IFRS Interpretations Committee to change the fixed dates in IFRS 1 to the 'date of transition to IFRSs'. The intention is to provide relief to first-time adopters from having to reconstruct transactions. The Board tentatively decided to publish an exposure draft with a 60-day comment period so that the relief may be available in time for those jurisdictions that are planning to adopt IFRSs in the near future.

Annual Improvements

The Board discussed four issues that the IFRS Interpretations Committee recommended that the Board should include within the next *Improvements to IFRSs* exposure draft to be published in October 2010.

IFRS 1 *First-time Adoption of International Financial Reporting Standards* - Clarification of borrowing costs exemption

The Board discussed a proposed amendment to clarify the accounting for borrowing costs at the date of transition to IFRSs. The issue arose because constituents perceived a lack of clarity in the guidance in IFRS 1 with respect to the accounting, at the date of transition, for borrowing costs capitalised in accordance with previous GAAP for projects completed or under-construction at the date of transition to IFRS.

The proposed amendment will clarify that the amount for capitalised borrowing costs determined under previous GAAP should be retained at the transition date, and that subsequent borrowing costs should follow the requirements of IAS 23.

The Board tentatively decided to include the proposed amendment within the next *Improvements to IFRSs* exposure draft.

IAS 16 *Property, Plant and Equipment* - Clarification of accounting for servicing equipment

The Board discussed a proposed amendment to address a perceived inconsistency in IAS 16 with respect to the classification of servicing equipment as property, plant and equipment (PP&E) or inventory.

The proposed amendment will clarify that servicing equipment is PP&E when used during more than one period; it should otherwise be classified as inventory. It will also delete the requirement that spare parts and servicing equipment used only in connection with an item of PP&E should be classified as PP&E.

The Board tentatively decided to include the proposed amendment within the next *Improvements to IFRSs* exposure draft.

IAS 32 *Financial Instruments: Presentation* - Tax effect of distributions to holders of equity instruments

The Board discussed a proposed amendment to address a conflict between IAS 12 *Income Taxes* and IAS 32 in respect of the accounting for income tax consequences of distributions to holders of equity instruments.

The proposed amendment is for IAS 32 to require the income tax consequences of distributions to holders of equity instruments to be accounted for in accordance with IAS 12.

The Board tentatively decided to include the proposed amendment within the next *Improvements to IFRSs* exposure draft.

IFRS 8 *Operating Segments* and IAS 34 *Interim Financial Reporting* - Consistency in disclosure of total segment assets

The Board discussed a proposed amendment to address a conflict within the standards with respect to the disclosure of segment assets. The perceived conflict is that IAS 34 could be read as requiring the disclosure of segment assets in interim financial reports regardless of whether that amount is regularly provided to the chief operating decision-maker.

The proposed amendment is to align the disclosure requirements in IAS 34 with those of IFRS 8.

The Board tentatively decided to include the proposed amendment within the next Improvements to IFRSs exposure draft.

Issues not recommended for inclusion within the Annual Improvements cycle for 2009-2011

Following the IFRS Interpretations Committee's recommendation, the Board tentatively decided that the three issues listed below did not meet the criteria for inclusion in Annual Improvements:

- IFRS 3 *Business Combinations* - Contingent consideration and first-time adoption
- IFRS 8 *Operating Segments* - Determination of scope. The Board tentatively decided that the issue goes beyond the scope for *Annual Improvements* and decided that it should instead be included in a review of the scope of IFRS 8 in a future post-implementation review of IFRS 8 and
- IAS 32 *Financial Instruments: Presentation* - Clarification of the puttable instruments criteria for income trust units.

Conceptual framework - measurement

The IASB reached the following tentative decisions relating to the development of preliminary views for the measurement chapter of the Conceptual Framework:

- **Implications of the objective of financial reporting for measurement** - the financial statements are complements, and all of them provide information that is useful to users of financial reports. Consequently, the best way to satisfy the objective of financial reporting through measurement is to consider the effect of a particular measurement selection on all of the financial statements, instead of emphasising the statement of financial position over the statement of comprehensive income or vice versa.
- **General implications of the fundamental qualitative characteristics for measurement** - an explanation of how the fundamental qualitative characteristics of useful financial information - relevance and faithful representation - must be considered in selecting measurements should be developed within the measurement chapter. The Board discussed specific points supporting this tentative decision which will be developed further.
- **Specific implications of the fundamental qualitative characteristics for historical cost and fair value** - the objective of selecting a measurement for a particular item is to maximise the information about the reporting entity's prospects for future cash flows subject to the ability to faithfully represent it at a cost that is justified by the benefits.
- **What should the measurement chapter accomplish** - the measurement chapter should list and describe possible measurements, arrange or classify the measurements in a manner that facilitates standard-setting decisions, describe the advantages and disadvantages of each measurement in terms of the qualitative characteristics of useful financial information, and discuss at a conceptual level how the qualitative characteristics and cost constraint should be considered together in identifying an appropriate measurement. Without prescribing specific measurements for particular assets and liabilities, the measurement chapter should discuss how its concepts might be applied to individual classes of assets and liabilities.

Consolidation

The IASB discussed the disclosure requirements for consolidated subsidiaries and unconsolidated structured entities. The Board tentatively decided that for subsidiaries with non-controlling interests that are individually material to a reporting entity, the reporting entity should disclose:

- the name;
- the country of incorporation or residence;

- the method of allocating the profits or losses to the non-controlling interest and, if it is different to the proportion of ownership interests, the proportion of voting rights held by the non-controlling interest; and
- summarised financial information.

The Board affirmed that a reporting entity should disclose information that helps users of financial statements to understand the nature of, and changes in, the risks associated with the reporting entity's involvement with structured entities. A reporting entity must provide this disclosure for both contractual and non-contractual involvements that expose the reporting entity to variability of returns of the structured entity.

In addition, the Board tentatively decided that that a reporting entity should be required to disclose for unconsolidated structured entities that the reporting entity has sponsored, but with which the reporting entity has no involvement at the reporting date:

- income in the reporting period from the structured entities that it has sponsored; and
- the carrying amount (at the time of transfer) of the assets transferred to those structured entities during the reporting period.

The reporting entity should present the information in a tabular format, unless another format is more appropriate, and separate the activity into relevant categories (such as by type of structured entity or asset that exposes the reporting entity to different risks). The reporting entity should also explain its policy as to how it determines whether it has sponsored a structured entity.

The Board's tentative decisions complete its deliberation of the responses to ED 10 *Consolidated Financial Statements*.

Derecognition

The IASB decided at this meeting to reconfirm the tentative decisions made at the March 2010 IASB meeting, when the Board discussed the responses received on the disclosure requirements proposed in the exposure draft - *Derecognition*. The Board tentatively decided to finalise those disclosure requirements, as an amendment to IFRS 7. The Board agreed that the effective date for the amendments should be 1 January 2011. Entities would be required to apply the amendment prospectively but retrospective application would be permitted.

Financial instruments - liabilities

In May 2010 the IASB published an exposure draft *Fair Value Option for Financial Liabilities*. The comment period ended on 16 July 2010. At this meeting the Board discussed an overview of the comments received on the ED. No decisions were made.

Financial instruments with characteristics of equity

The IASB discussed some of the more significant comments received from external reviewers on a staff draft of the exposure draft *Financial Instruments with Characteristics of Equity*. The Board also discussed the next steps in the project, specifically whether it should continue to pursue the proposed approach or else retain the requirements in IAS 32 *Financial Instruments: Presentation* (and perhaps address particular practice problems that have arisen from that Standard). The Board noted that additional meetings are needed to discuss the best way forward. No decisions were made.

Hedge accounting

Fair value hedge accounting mechanics

At a previous meeting in September 2009, the IASB tentatively decided to improve hedge accounting requirements by replacing the mechanics used for fair value hedge accounting with an approach that is similar to cash flow hedge accounting (the tentative approach). In response to feedback received from the outreach activities on that tentative approach, the Board changed its tentative decision IAS 34 to an approach for fair value hedge accounting that presents the cumulative gain or loss on the hedged item attributable to the hedged risk as a separate line item in the balance sheet. That line item is presented within assets (or liabilities) for those reporting periods for which the hedged item is an asset (or liability). The fair value changes of the hedging instrument and the hedged item attributable to the hedged risk are taken to other comprehensive income, and any ineffectiveness (ie any difference) is transferred immediately to profit or loss.

Linked presentation

At this meeting the Board discussed whether it should require linked presentation for fair value hedges. Linked presentation results in the gross assets and gross liabilities that are related because of the application of fair value hedge accounting being presented in proximity to one another (ie on the same side) on the face of the statement of financial position. The Board tentatively decided not to allow linked presentation because of the many different types of relationship that can exist between assets and liabilities, which would make it too difficult to establish an appropriate basis for determining when linked presentation would be required.

Eligible hedged items: groups and net positions

At this meeting the IASB continued its discussions of hedging groups and net positions focusing on two particular aspects.

First, it discussed the merits of permitting hedge accounting for net positions of forecast transactions. The Board looked at an example of forecast sales and cost of sales hedged on a net basis for foreign currency exchange risk using forward exchange contracts. The Board tentatively agreed to permit hedge accounting for such net positions, subject to consideration of other consequences of hedging net positions that may arise as the staff continue to explore the issues.

Second, it discussed different ways by which hedged items could be identified when they are hedged as part of a group. The Board looked at what an appropriate method would be to identify the hedged items when a net position is hedged. The Board tentatively decided that items in a net position hedge could be identified as individual gross items that can offset both within and across reporting periods provided that this could be done with a clear and robust link to risk management.

The discussions of whether net positions should qualify for hedge accounting will continue at a future meeting.

IAS 29 *Financial Reporting in Hyperinflationary Economies*

The IASB discussed a recommendation from the IFRS Interpretations Committee to amend IAS 29. The proposed amendment would clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity, or an interest held by the entity, was unable to comply with IAS 29 because it had a functional currency that was subject to severe hyperinflation.

The Board requested that the staff perform additional work including:

- further outreach with jurisdictions that have been subject to hyperinflation;
- analysis of whether, in the consolidated financial statements of parents, venturers and investors, differences arising on application of the proposed guidance should be recognised in profit or loss or as a component of equity;
- research on the number of entities in jurisdictions applying IFRSs that are currently affected by severe hyperinflation; and
- considering whether the accounting for an entity subject to severe hyperinflation should be addressed separately from the accounting for an entity with an interest that is subject to severe hyperinflation.

No decisions were made.

IFRS Advisory Council: Update from last meeting

Paul Cherry, the Chairman of the IFRS Advisory Council, gave the Board an update via video from Toronto of the IFRS Advisory Council meeting held in London in June. A recording of the meeting and a staff summary will be available on the IASB website shortly.

IFRS Interpretations Committee update

The Board discussed the IFRS Interpretations Committee's meeting on 6 and 7 July 2010. Details of the meeting were published in IFRIC Update, available **here**.

Income taxes

In March 2010, the IASB decided that the revised scope of the income taxes would include:

- deferred tax on remeasurement of investment property at fair value;
- uncertain tax positions, but only after the Board completes its current deliberations on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- implementation of particular proposals in the 2009 exposure draft *Income Tax* that received general support from respondents.

At this meeting, the Board discussed deferred tax on remeasurement of investment properties at fair value, and tentatively decided:

- to introduce an exception to the measurement principle in paragraph 52 of IAS 12 *Income Taxes*. That principle requires an entity to measure deferred tax in a manner consistent with the expected manner of recovery of the asset that generates the deferred tax. When the exception applies, an entity would measure any deferred tax liability in a manner that reflects the tax that the entity will pay if it sells the asset, or if lower, the tax that it will pay if it uses the asset.
- the exception would apply for investment properties, property, plant and equipment or intangible assets measured at fair value using the fair value model under IAS 40 *Investment Property* or the revaluation model in IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*. The exception would also apply for investment properties, property, plant or equipment or intangible assets measured at fair value in a business combination under IFRS 3 *Business Combinations*.

Next steps

The Board instructed the staff to draft an exposure draft dealing with the exception described above, so that other issues within the scope of this project do not delay the resolution of this issue.

In addition, the staff plan to ask the Board:

- to review in September or October 2010 the issues arising from the 2009 exposure draft and
- to consider how to proceed in October or November 2010 on uncertain tax positions, after the Board has reviewed the comment letters on the exposure draft *Measurement of Liabilities in IAS 37*.

Insurance contracts

Unbundling
The IASB and FASB decided tentatively to require unbundling on the basis of the following principle:

> *If a component is not closely related to the insurance coverage specified in a contract, an insurer shall account for that component as if it were a separate contract and apply the relevant standard to that component (ie shall unbundle that component).*

The boards also agreed to specify the most common examples of components that are not closely related to the insurance coverage, namely:

- an investment component reflecting an account balance that meets both of the following conditions:
  1. the account balance is credited with an explicit return (ie it is not an implicit account balance, for example derived by discounting an explicit maturity value at a rate not explicitly stated in the contract); and
  2. the crediting rate for the account balance is based on the investment performance of the underlying investments, namely a specified pool of investments for unit-linked contracts, a notional pool of investments for index-linked contracts or a general account pool of investments

for universal life. That crediting rate must pass on to the individual policyholder all investment performance, net of contract fees and assessments.

- an embedded derivative that is separated from its host contract in accordance with existing bifurcation guidance.
- contractual terms relating to goods and services that are not closely related to the insurance coverage, but have been combined in a contract with that coverage for reasons other than economic.

In clarifying how to unbundle the account balance, the IASB exposure draft will clarify that an insurer shall regard all charges and fees assessed against the account balance, as well as cross-subsidy effects included in the crediting rate, as belonging to either the insurance component or another component, not as part of the investment component.

Unit-linked contracts
The boards discussed accounting mismatches arising from the measurement of unit-linked contracts. The current draft of the IASB exposure draft defines those contracts as contracts for which some or all of the benefits are determined by the price of units in an internal or external investment fund (ie a specified pool of assets held by the insurer or a third party and operated in a manner similar to a mutual fund).

The discussion focused on the following items held in such funds:

- the insurer s own shares; and
- owner-occupied real estate, owned by the fund and occupied by the insurer.

Regarding those own shares, the boards tentatively decided that an insurer should recognise them and measure them at fair value through profit or loss.

For owner-occupied real estate, the IASB tentatively decided that an insurer:

- should measure this asset at fair value;
- recognise changes in that fair value through profit or loss to the extent those changes relate to the interest of unit-linked contract holders in the pool of assets.
- recognise in other comprehensive income those changes in fair value attributable to the insurer s own interest in the pool of assets.

The FASB did not make a decision on owner-occupied real estate.

The boards also decided not to provide guidance on issues that might arise if subsidiaries are held in a fund underlying unit-linked contracts.

The boards tentatively decided that an insurer should present:

- assets and liabilities associated with unit-linked contracts as single line items in the statement of financial position and not commingle them with the insurer s assets.
- income and expense arising from the pool of assets underlying unit-linked contracts as a single line item and not commingle them with income and expense arising from the insurer s other assets.

Measurement approach for short-duration contracts
The boards discussed remaining issues relating to the measurement model for short-duration contracts (premium allocation model).

The IASB affirmed its previous decision to require, rather than merely permit, the application of the premium allocation model for the pre-claims liability of short-duration contracts and decided tentatively to apply it to short-duration contracts incorporating both of the following features:

- the coverage period is approximately 12 months or less; and
- the contracts do not contain embedded options or guarantees that are not separated under the bifurcation requirements and also have a significant impact on the variability of cash flows during the coverage period.

The IASB, discussed whether to include the following third condition and decided not to include it: the insurer is unlikely to become aware of events during the coverage period that could cause significant decreases in the expected cash out flows.

Regarding the treatment of acquisition costs under the premium allocation model, the IASB decided tentatively:

- to defer incurred incremental acquisition costs associated with insurance contracts that are measured and presented using that model.
- to present those deferred acquisition costs as a deduction from the unallocated premium liability.

The IASB also decided tentatively:

- that an insurer should accrete interest on the contract position (expected present value of remaining premiums less unallocated premium obligation). The IASB noted that such interest might often be immaterial.
- to use a current rate to accrete interest to an unallocated premium liability.

The FASB will continue its deliberations on the premium allocation model during its meeting on 28 July.

Investment contracts with a Discretionary Participating Feature
The IASB discussed the treatment of the residual margin associated with the measurement of an investment contract containing a discretionary participating feature. The IASB tentatively decided that an insurer should recognise that residual margin in profit or loss over the life of the contract in a systematic way that best reflects the asset management services, as follows:

a. on the basis of passage of time, but
b. if the insurer expects to provide asset management services in a pattern that differs significantly from passage of time, it shall release the residual margin on the basis of the fair value of assets under management.

Next steps
The IASB expects to publish an exposure draft *Insurance Contracts* at the end of July.

The FASB met on 28 July, 2010 to discuss the measurement and presentation approach for short-duration contracts and next steps related to the project, including whether it will issue an Exposure Draft based on the tentative decisions to date or issue a Discussion Paper that seeks further input. Information about the FASB   s decision can be found at:
http://www.fasb.org/jsp/FASB/Page/SearchActionAlerts?filter_year=2010.

Leases

Scope - purchase or sale of underlying asset

The IASB and FASB tentatively decided to keep the requirement to exclude contracts that are purchases or sales of the underlying asset from the scope of the proposed new leases requirements. However, the boards tentatively decided to remove the following two criteria from the list of indicators that a contract is a purchase and sale:

- the contract covers the whole of the expected useful life of the asset; and
- the contract specifies a fixed return to the transferor.

For determining whether a contract is a purchase or sale (both for scope purposes and for sale and leaseback transactions), the boards confirmed their previous tentative decision that a contract is a purchase or sale of an underlying asset if, at the end of the contract, an entity transfers to another entity control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying asset.

Lessor accounting - accounting for arrangement with service and lease components

The boards had differing views. The FASB tentatively decided that lessors should not bifurcate non-distinct services from the lease components in a lease arrangement under the derecognition approach to lessor accounting. The IASB tentatively decided that under the derecognition approach to lessor accounting, the lessor should be required to bifurcate non-distinct services from the lease components. The IASB also tentatively decided that the service element of the contract should be accounted for in accordance with the proposed new guidance on revenue recognition. Although the FASB decided that non-distinct services should not be bifurcated, they tentatively decided that if non-distinct services were bifurcated, the lessor should recognise a receivable for both the service and lease elements, and should recognise a separate performance obligation for the service component.

Consequential amendments - Business combinations

The boards tentatively decided that, for leases acquired in a business combination, an adjustment would be made to the right-of-use asset for the lessee and the performance obligation for the lessor, reflecting the difference between the rate charged in the lease and market rates.

The boards also tentatively decided that if the acquired entity is a lessor under the derecognition approach to lessor accounting, the acquirer would measure the right to receive rentals initially at the present value of the remaining rental payments, discounted using the acquirer's discount rate. The lessor's residual asset would be measured at fair value.

Additional disclosures

The boards tentatively decided that a lessor shall disclose:

- its accounting policy regarding which accounting model(s) the lessor applies;
- the types of risks/benefits of the underlying asset that the lessor considered when deciding which accounting model to apply; and
- any impairment recognised, separately for each accounting model.

The boards also tentatively decided that lessors and lessees should disclose the existence and principal terms of any purchase options.

Application guidance on when to use the performance obligation or derecognition approach to lessor accounting

The boards tentatively decided that a lessor shall account for a lease contract based on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset either:

- during the expected term of the current lease contract; or
- subsequent to the term of the current lease contract, by having the expectation or ability to generate significant returns by leasing that asset multiple times subsequent to the current contract, or by selling the underlying asset.

For the purposes of this assessment, risks associated with the counterparty credit risk of the lessee shall not be considered.

A lessor that retains exposure to significant risks or benefits associated with the underlying asset shall apply the performance obligation approach to such leases. A lessor that does not retain exposure to significant risks or benefits associated with the underlying asset would apply the derecognition approach to such leases. This assessment would be made at the inception of the lease and would not be reassessed subsequently.

The boards tentatively decided that a lessor shall consider the following factors when determining whether it retains exposure to significant risks or benefits associated with the underlying asset during the expected term of the current lease contract:

- significant contingent rentals during the expected lease term that are based on the use or performance of the underlying asset;
- options to extend or terminate the current lease term; and
- material non-distinct services provided under the current lease contract.

The boards tentatively decided that a lessor shall consider the following factors when determining whether it retains exposure to significant risks or benefits associated with the underlying asset subsequent to the term of the current lease contract.

- whether the lease term is short in relation to the useful life of the asset; and
- whether a significant change in the value of the underlying asset at the end of the lease term is expected. In making this assessment, the lessor shall consider the present value of the underlying asset at the end of the lease term and the effect that any residual value guarantees may have on the lessor's exposure to risks and benefits.

The board also tentatively decided:

- to consider third party residual value guarantees when determining whether a lessor is exposed to significant risks and benefits associated with the underlying asset; and
- not to include specific guidance on long-term leases of land in the application guidance.

Rate-regulated activities

The IASB continued its discussions on the responses received on its exposure draft *Rate-regulated Activities* published in July 2009. At this meeting, the Board focused on the key issue of whether regulatory assets and regulatory liabilities exist, whether they should be recognised in accordance with the current *Framework for the Preparation and Presentation of Financial Statements* and whether they are consistent with other current IFRSs. The Board reviewed analyses of several aspects of the key issue prepared by the staff including an analysis of the regulatory environment, comparison to current IFRSs, comparison to other current Board projects, analysis of the unit of account to apply to this project, a summary of outreach efforts, a summary of the potential application of this project to non-utility entities and a summary of requests for an interim standard.

The Board discussed how to continue with this project. The Board is divided on whether to amend IFRSs to require the recognition of regulatory assets and liabilities and, if so, how to measure those regulatory assets and liabilities. The issues raised by this project relate to broader concerns on the accounting for intangible assets, and decisions reached on this project may have broader implications than originally anticipated.

The Board discussed whether an interim IFRS should be developed to assist countries moving to IFRSs in the near future. The Board decided that it should not develop an interim standard, but should instead continue to progress the work on the current project. Accordingly, the Board directed the staff to continue its research and analysis on this project to permit future deliberations by the Board as time and resources permit, acknowledging the existing guidance and current practice that has developed in the 110+ countries that apply IFRSs.