BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

December 2008

IASB Update *is published as a convenience for the Board's constituents. All conclusions reported are tentative and may be changed or modified at future Board meetings.*

Decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an exposure draft.

The International Accounting Standards Board met in London on 15 – 19 December, when it discussed:

- Global financial crisis
- Annual improvements
- Conceptual framework
- First time adoption of IFRSs
- IFRS for private entities
- Liabilities – amendments to IAS 37
- Rate-regulated activities
- Share-based payment

Global financial crisis

The Board discussed various aspects of its response to the global financial crisis:

- Derecognition
- Financial instruments
- Fair value measurement

Derecognition

The Board continued its discussion of the two approaches to derecognition that the staff presented at the joint meeting with the US Financial Accounting Standards Board (FASB) in October. The Board made the following tentative decisions:

- For Approach 1, to focus solely on whether, after the transfer, the transferor has access to all or some of the cash flows of the financial asset that the transferor recognised before the transfer.
- For Approach 2, to continue to include economic constraints (including some options allowing the transferee to put a transferred asset back to the transferor) in the assessment of whether a transferee has the practical ability to transfer to a third party for its own benefit the financial asset that it purchased from the transferor.

The Board also tentatively adopted the following derecognition principle for financial liabilities:

> "An entity should derecognise a financial liability or component thereof when it no longer qualifies as a liability of the entity (ie when the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation)."

The Board also discussed secured borrowings with or without recourse, security lending arrangements and repurchase agreements (repos). For secured borrowings with recourse and security lending arrangements and repos, the Board made the following tentative decisions:

- Secured borrowings with recourse and securing assets should be accounted for similarly to unsecured borrowings and unpledged assets.
- Any restrictions on a debtor's ability to benefit from the securing asset should be addressed by disclosure.
- Security lending arrangements and repos involving readily obtainable financial assets should qualify for derecognition.

The Board made no tentative decisions on the accounting for secured borrowings without recourse and the related securing assets.

The Board will continue its discussion at its meeting in January and expects to publish an exposure draft in March or April 2009.

Financial instruments

In October the IASB and the US Financial Accounting Standards Board announced their joint approach to financial reporting issues arising from the global financial crisis. As part of that approach, the boards held three public round table meetings in November and December - one each in Europe, North America and Asia. The round tables were arranged to help the boards identify accounting issues that might require their urgent and immediate attention to improve financial reporting and help enhance investor confidence in financial markets.

At this meeting, the Board discussed some of the main suggestions made by round-table participants and decided to publish two exposure drafts (EDs):

- One ED will propose clarifying that, when an entity reclassifies a hybrid financial asset out of the fair value through profit or loss category, the entity must assess whether it must separate an embedded derivative from the host contract. The ED will also address other issues related to that clarification.
- The other ED will propose additional disclosure requirements for investments in debt instruments (other than those classified as at fair value at through profit or loss). (The FASB is expected to propose similar disclosure requirements.)

The Board expects to publish both EDs by the end of 2008.

The Board also tentatively decided to consider urgently with the FASB other suggestions made by round table participants as part of the boards' broader project on accounting for financial instruments:

- accounting for impairments of financial assets, including impairment triggers and reversals of impairment losses for available-for-sale equity instruments
- the fair value option (FVO), including its scope, the eligibility requirements in IAS 39 and the ability to reclassify financial instruments classified as at fair value through profit or loss under the FVO to another category

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Responding to particular practice problems raised by round-table participants, the Board tentatively decided that additional IFRS guidance on the following three topics is unnecessary at this time:

- the definition of held for trading
- accounting for investments in collaterised debt obligations
- measuring financial instruments when markets are no longer active.

Fair value measurement

The Board discussed the following topics:

- Defensive intangible assets
- Reference markets
- Valuation premise
- Day 1 gains or losses
- Restrictions on assets and liabilities
- Highest and best use change of use option
- Credit standing
- Fair value definition for liabilities

Defensive intangible assets

In some business combinations, the acquirer acquires intangible assets but does not intend to use them directly or does not intend to use them in the same way as other market participants (these are commonly called 'defensive intangible assets').

The Board tentatively decided:

- to confirm its decision in IFRS 3 *Business Combinations* (as revised in 2008) that an acquirer should, in a business combination, recognise these intangible assets and measure them at fair value.
- not to provide explicit guidance on measuring the fair value of such intangible assets. The exposure draft will describe how these intangible assets are identified and the implications of the notions of highest and best use, valuation premise and market participant.
- not to address subsequent accounting for these intangible assets.
- not to require additional disclosures about these intangible assets.

Reference markets

The Board discussed the reference market for a fair value measurement. The Board tentatively decided that:

- a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the most advantageous market for the asset or liability. The most advantageous market is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, considering transaction cost and transportation cost in the respective market(s).
- an entity need not undergo an exhaustive search of all possible markets when identifying the most advantageous market. The entity may use the principal market for the asset or liability unless there is evidence that a more advantageous market exists. The principal market is the market with the greatest volume of activity for the asset or liability, provided that the entity would sell the asset or transfer the liability in this market. There is a rebuttable presumption that the principal market is the most advantageous market and that it is the market in which the entity would normally transact.
- when there is not an observable market, an entity should consider the characteristics of market participants with whom the entity would transact to sell an asset or to transfer a liability.

Valuation premise

The Board tentatively decided that:

- a fair value measurement should consider whether market participants would maximise the value of an asset principally through its use in combination with other assets as a group (in-use) or on a stand-alone basis (in-exchange). The exposure draft will explain the valuation premise concept and how it is relevant to an exit price notion.
- the valuation premise and highest and best use concepts are not relevant for liabilities and for financial assets.
- the exposure draft should highlight the fact that an exit price considers a market participant's ability to generate economic benefit by using an asset or by selling it to a third party. However, the definition of fair value should not refer explicitly to this fact.
- the exposure draft should not replace the terms 'in-use' and 'in-exchange'.

Day 1 gains or losses

The Board discussed whether it is appropriate to recognise a gain or a loss when IFRSs require or permit fair value at initial recognition if the measurement is derived using unobservable inputs. The Board will determine for each IFRS that requires or permits a fair value measurement at initial recognition whether an entity may recognise a day 1 profit or loss.

The Board tentatively decided that:

- the transaction price is the best evidence of the fair value of an asset or liability at initial recognition unless:
  - (a) the transaction is between related parties;
  - (b) the transaction is made under duress or the seller is forced to accept the price in the transaction;
  - (c) the unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value;
  - (d) the market in which the transaction is made is different from the market in which the reporting entity would sell the asset or transfer the liability.
- if there is evidence that the transaction price does not represent fair value at initial recognition, an entity recognises a day 1 gain or loss, even when the initial fair value measurement is derived using unobservable inputs.
- when an entity recognises a day 1 profit or loss, the entity must disclose:
  - (a) the amount of profit or loss recognised at inception for the period and the level in the fair value hierarchy on which the fair value measurement is based;
  - (b) the reason(s) why the entity determined that transaction price was not the best evidence of fair value; and
  - (c) information about the entity's price verification procedures and review processes, including the control environment surrounding them.

Restrictions on assets and liabilities

The Board discussed how a restriction on the sale of an asset or the transfer of a liability would affect a fair value measurement.

The Board tentatively decided that:

- if a restriction on the use or sale of an asset would transfer to market participants, the restriction is an attribute (characteristic) of the asset and affects the fair value of that asset. If a restriction on an asset would not transfer to a market participant buyer, it does not affect the fair value of the asset. The existence of a restriction depends on the characteristics of the asset that the market participant buyer receives, and therefore would pay for, not on the characteristics of the asset in the hands of the existing holder.
- a restriction on the transfer of a liability does not affect the fair value of that liability. The fair value of a liability, unlike an asset, is not a function of marketability, but of performance. A market participant transferee would be obliged to perform and would take that into account when considering the amount that it would demand to assume the liability.
- 'the ability to access' in the definition of a Level 1 input means that the entity can access the market for a restricted asset when the restriction ceases to exist. The entity does not need to be able to sell the asset on the measurement date.

Highest and best use change of use option

The Board reaffirmed the tentative decision in September 2008 that when the highest and best use of an asset that is used together with another asset differs from the asset's current use, an entity may need to split the fair value of the asset group into components:

- the value of the assets in the asset group assuming their current use and
- the incremental value reflecting the difference between the value of the assets in their current use and the fair value of the asset group.

This difference might arise for asset groups comprising both depreciable and non-depreciable assets. The value of an asset assuming its current use differs from the fair value of the asset in that the current use value does not reflect the asset's highest and best use. However, it reflects other market participant assumptions.

Credit standing

The discussion paper *Fair Value Measurements* expressed the Board's preliminary view that the fair value of a liability reflects non-performance risk (including credit standing). At this meeting, the Board tentatively reaffirmed this view. The Board tentatively decided to clarify in the exposure draft how this conclusion relates to other conclusions in this project that exclude consideration of actions that are not legally permissible.

The Board noted that many commentators continue to question whether decision-useful information results from including the effect of non-performance risk in the measurement of a liability. The Board noted that this question is beyond the scope of the project on fair value measurement, but instructed the staff to develop a separate document on this topic for public comment.

The definition of fair value for liabilities

The Board tentatively reaffirmed its preliminary view that the fair value of a liability is 'the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date'. The exposure draft will describe what a transfer price represents, including how it relates to a settlement amount with a counterparty. It will also provide guidance on how to measure the fair value of a liability when there is not an observable market price for the liability.

In January 2009 the Board will discuss whether it or its predecessor intended a transfer price notion when existing IFRSs refer to the fair value of a liability. If that was not the intention, the Board will discuss whether to exclude the measurement of that particular liability from the scope of an IFRS on fair value measurement.

Annual improvements

Annual improvements – 2007

The Board discussed three issues outstanding from the exposure draft of proposed Improvements to International Financial Reporting Standards, published in October 2007.

IAS 39 *Financial Instruments: Recognition and Measurement* – Treating loan prepayment penalties as closely related embedded derivatives

The Board considered comments received on the proposal to clarify paragraph AG30(g) of IAS 39. The proposal would clarify that if the exercise price of a prepayment option reimburses the lender for the present value of lost interest for the remaining term to maturity of the original contract, the option is closely related to the host debt contract.

The Board decided to proceed with the proposed amendment.

IAS 1 *Presentation of Financial Statements* – Current/non-current classification of convertible instruments

The Board considered comments received on the proposal to clarify that the potential settlement of a liability by issuing equity instruments is not relevant to the determination of the liability's classification as current or non-current.

The Board decided to amend IAS 1.

IAS 17 *Leases – Classification of land leases*

The Board considered comments received on the proposal to address a perceived inconsistency in the classification guidance in IAS 17 for leases of land and buildings.

The Board reaffirmed its view that the proposed change would be an improvement.

The Board acknowledged that the active project on leases is scheduled to produce a standard in 2011. However, the Board decided to conclude this proposal separately now in case the lease project is delayed.

The Board agreed with the additional revisions that the staff recommended to finalise the amendment, including drafting changes and a modified retrospective transition, which would require an entity to reassess the classification of unexpired land leases at the date the amendment is adopted. A lease newly classified as a finance lease would be recognised at either:

- the fair value of the land component on the date of adoption; or
- the fair value of the land component reported in previously published financial statements, if available.

Finalising the amendments

The Board plans to issue the amendments related to these three issues, as revised, as part of the improvements to IFRSs resulting from the exposure draft of August 2008. The Board expects to publish those amendments in April 2009, with an effective date of 1 January 2010.

Annual improvements – 2009

The Board discussed four issues for possible inclusion in the next exposure draft, which it expects to publish in August 2009.

IAS 18 *Revenue* – Clarification of inconsistent guidance

The Board received a request in October 2008 to review consistency between the principles set out in IAS 18 and Example 17 of its Appendix, which deals with initiation, entrance and membership fees. The Board decided not to include this issue in this project.

IAS 40 *Investment Property* – Change from fair value model to cost model

IAS 40 deals inconsistently with decisions to develop or sell investment property previously measured using the fair value model:

- an entity continues using the fair value model when a property is removed from active service while being renovated for continuing future use as an investment property.
- when there is 'commencement of development with a view to sale', an investment property is transferred to inventories and is within the scope of IAS 2 *Inventories*;
- when criteria in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are met, the entity continues to use the fair value model.

The Board tentatively decided to remove the requirement to transfer investment property to inventories when it will be developed before sale, add a requirement for investment property held for sale to be displayed as a separate category in the statement of financial position, and require disclosures consistent with IFRS 5.

IFRS 3 *Business Combinations* – Customer-related intangible assets

The IFRIC received a request to provide guidance on a non-contractual customer relationship acquired in a business combination. At its meeting in November 2008 the IFRIC recommended that both the IASB and the FASB should:

- remove the distinction between the treatments of 'contractual' and 'non-contractual' customer-related intangible assets in a business combination and focus on the nature of the relationship rather than how it is established; and
- review the indicators that identify the existence of a customer relationship in paragraph IE28 of the guidance on implementing IFRS 3 and include them in the standard (IASB only).

The Board tentatively decided to consider a proposed amendment to IFRSs. The staff will liaise with the FASB to develop a project plan and prepare additional analysis for a future meeting.

IFRS 7 *Financial Instruments: Disclosures*

The Board discussed some application issues related to IFRS 7 *Financial Instruments: Disclosures* and tentatively decided to propose amendments to IFRS 7 that:

- state that the qualitative disclosures in paragraph 33 should support and enhance the quantitative disclosures in paragraphs 34-42 of the IFRS.
- remove the reference to materiality from paragraph 34(b).
- clarify that the disclosure requirement in paragraph 36(a) applies only to assets, and off balance sheet exposures, whose carrying amounts do not show the reporting entity's maximum exposure to credit loss.
- require the disclosure of the financial effect of collateral held as security and other credit enhancements in paragraph 36(b).
- remove the disclosure requirement in paragraph 36(d) related to financial instruments renegotiated to avoid becoming past due or impaired.
- remove the disclosure requirement in paragraph 37(c) related to collateral held as security or other credit enhancements.
- clarify that the disclosure requirement in paragraph 38 applies only to foreclosed collateral held at the reporting date.

Conceptual framework

Objective and Qualitative Characteristics

The Board noted a summary of comments received on the exposure draft *An improved Conceptual Framework: Chapter 1: The Objective of Financial Reporting and Chapter 2: Qualitative Characteristics* and *Constraints of Decision-useful Financial Reporting Information* and the plans for redeliberations. No decisions were made.

The summary can be found here: http://www.iasb.org/Current+Projects/IASB+Projects/Conceptual+Framework/Meeting+Summaries+and+Observer+Notes/IASB+December+2008.htm

First-time adoption of IFRSs

The Board tentatively decided to change the effective date of revised IFRS 1 *First-time Adoption of International Financial Reporting Standards* (published in November 2008) from 1 January 2009 to 1 July 2009. The proposed amendment removes a potential technical problem arising from the interaction of IFRS 1 and the revised IFRS 3 *Business Combinations* and amended IAS 27 *Consolidated and Separate Financial Statements*, both published in January 2008. The amendment does not affect the application of IFRS 1 by first-time adopters. The change in the effective date will be reflected in the electronic version of IFRS 1 (published in November 2008) included in eIFRS and in the 2009 Bound Volume of IFRSs.

IFRS for private entities (formerly small and medium-sized entities, or SMEs)

At this meeting the Board discussed some of the remaining issues relating to the proposed IFRS for Private Entities.

Financial statement presentation. At its meeting in May 2008, the Board tentatively decided that *the IFRS for Private Entities* should incorporate the requirements of IAS 1 *Presentation of Financial Statements* as revised in 2007. At this meeting the Board considered issues resulting from that decision, and made the following tentative decisions:

- Entities should have the option to present either a single statement of comprehensive income or two separate statements—an income statement displaying components of profit or loss and a statement of comprehensive income beginning with profit or loss and displaying components of other comprehensive income (OCI).
- If an entity has no items of OCI, the statement of comprehensive income need not have a subtotal for 'profit for the period'. Instead, the bottom line could be labelled 'profit and comprehensive income for the period'. Furthermore, because an entity may use titles for financial statements other than those in the IFRS, if an entity has no items of OCI, the title of the statement could be, for example, 'statement of profit or loss' or 'statement of income'.
- An entity should not be required to present a statement of financial position as at the beginning of the earliest comparative period when the entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. IAS 1 (revised 2007) would require such a presentation.

Impairment of non-financial assets. The staff presented a revised Section 26 *Impairment of Non-financial Assets* reflecting tentative decisions made by the Board in July 2008. The revision:

- modifies the general approach for the impairment of non-financial assets to include the 'recoverable amount' and 'value in use' concepts;
- simplifies the requirements for assessing goodwill impairment; and
- introduces the concept of a cash-generating unit.

The indicator approach to impairment proposed in the ED is retained. In general, the Board was supportive of the rewrite. However, a few inconsistencies were highlighted, for example, regarding determining fair value in a forced sale (paragraph 26.14 of the rewrite). The Board also suggested modifications, such as deleting the 'market capitalisation' impairment indicator, deleting paragraph 23.13 (on allowing value in use to be used as recoverable amount in some circumstances) and shortening the section (for instance, some of the guidance for value in use could instead be covered by the training materials being developed by the IASC Foundation) to make it more manageable for private entities.

Financial instruments. In June 2008, the Board asked the staff to redraft Section 11 *Financial Assets and Financial Liabilities* and to present a recommendation at a future Board meeting. Among the tentative decisions made by the Board in June were:

- Restructure Section 11 in two parts with one part (Section 11A) dealing with the simple payables and receivables and other basic financial instruments, and the second part (Section 11B) dealing with the more complex instruments and transactions.
- Clarify, by giving examples of the types of financial instruments that a private entity is likely to have, that the cost model will be appropriate for the significant majority of financial instruments held by private entities. A private entity with no other financial instruments would then not need to consider Section 11B.

The Board considered the first draft of Section 11A at this meeting and decided that changes or clarification are needed in a number of areas including:

- the initial measurement of a financial instrument: the fair value of whatever is receivable (for an asset) or payable (for a liability);
- the need to identify clearly which basic financial instruments cannot be carried at amortised cost; and
- derecognition, including factoring.

The staff will present an updated version of Section 11A at the meeting in January, along with a draft of Section 11B.

Outstanding issues. At its meeting in January, the Board will discuss the main outstanding issues, which include amortisation of goodwill, a requirement to prepare consolidated financial statements, whether the *IFRS for Private Entities* should allow use of the complex options, the section on concepts and pervasive principles, simplification of defined benefit pension accounting, and the revised and complete proposal for financial instruments.

Liabilities – Amendments to IAS 37

The exposure draft of proposed amendments to IAS 37, published in 2005, proposes to eliminate from IAS 37 the term 'contingent liability'. One consequence is that entities would no longer be required to disclose information about 'possible obligations', ie situations—such as contested lawsuits—in which it is possible, but not probable, that an entity has a liability at the end of the reporting period.

The Board noted that some respondents to the exposure draft were concerned that the removal of the requirement to disclose possible obligations would result in a loss of useful information for users of financial statements. The Board tentatively decided that the revised IAS 37 should require entities to disclose information about possible obligations, such as those arising from legal, arbitration and governmental proceedings that are in progress, pending or threatened against the entity. The information disclosed should include an estimate of the amounts involved.

Rate-regulated activities

The Board decided to add to its agenda a project on rate-regulated activities. The issue is whether regulated entities could or should recognise an asset or a liability as a result of rate regulation imposed by regulatory bodies or governments.

Share-based payment

The Board resumed its redeliberation of the exposure draft *Group Cash-settled Share-based Payment Transactions* published in December 2007. The exposure draft addresses how an entity that receives goods and services from its suppliers should account in its separate financial statements for share-based payment arrangements that are settled in cash by a group entity on its behalf.

The Board discussed the staff analysis and the proposed 'measurement of these arrangements as recommended by the IFRIC. The Board tentatively agreed with the IFRIC's recommended changes from the measurement proposals in the exposure draft. The Board directed the staff to prepare a draft amendment to IFRS 2 *Share-based Payment* reflecting the Board's tentative decisions. The Board will consider at a future meeting whether re-exposure of the amendment is necessary.

Future Board meetings

The Board will meet in public session on the following dates. Meetings take place in London, UK, unless otherwise noted.

2009

19-23 January

16-20 February

16-20 March

20-24 April

18-22 May

15-19 June

20-24 July

14-18 September

19-23 October

16-20 November

14-18 December