BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

June 2009

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 June, when it discussed:

- Financial instruments
- Conceptual framework
- Financial instruments with characteristics of equity
- Insurance contracts
- Joint ventures
- Leases
- Liabilities – amendments to IAS 37
- Rate-regulated activities
- Revenue recognition
- Annual improvements

Financial instruments

The Board continued to discuss its plan to publish an exposure draft (ED) in July 2009 on the classification and measurement of financial instruments as part of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The Board also discussed these issues at additional Board meetings on 1 June and 5 June. The Board plans to publish further EDs on the impairment of financial assets (see below) and hedge accounting later in 2009.

The classification and measurement approach being developed would measure almost all financial assets and financial liabilities at either amortised cost or fair value. If financial instruments have only basic loan features and are managed on a contractual yield basis, they would be measured at amortised cost. All other financial instruments would be measured at fair value, except some items discussed below under 'other issues'. The existing categories of loans and receivables, held-to-maturity investments and available-for-sale financial assets would disappear.

The Board made the following tentative decisions:

- If the host contract of a hybrid contract is within the scope of IAS 39, the proposed classification approach would apply to the entire hybrid contract and the host contract would not be separated from the embedded derivative(s). If the hybrid contract contains only an embedded derivative that is a basic loan feature, such as an interest rate cap, floor or collar that combines a fixed interest and variable interest rate, that hybrid contract (as a whole) would qualify for amortised cost classification.
- The application guidance would address how to apply the classification approach to investments in structured investment vehicles with a 'waterfall' feature.
- If the host contract of a hybrid contract is not within the scope of IAS 39, it would be measured using the existing requirements for embedded derivatives in IAS 39, pending a review of the scope of IAS 39 in a later phase of this project.
- A fair value option would be retained. Entities could elect to measure at fair value financial instruments that qualify for amortised cost measurement if the use of that option eliminates or significantly reduces a measurement or recognition inconsistency. (IAS 39 provides the fair value option in two other cases, but the Board's other proposals would make them unnecessary: (a) if an entity manages assets or liabilities on a fair value basis, they cannot qualify for amortised cost measurement because the entity is not managing them on a contractual yield basis; (b) embedded derivatives would no longer be separated.)

Entities could elect to present fair value changes for an investment in equity instruments that are within the scope of IAS 39 (other than those investments that are held for trading) in other comprehensive income (OCI). The amounts recognised in OCI would not be recycled to profit or loss on disposal or in any other circumstances. Thus, there would be no impairment testing for these assets. Entities could make this presentation election for each holding of an instrument at initial recognition and the election would be irrevocable for that holding. An entity need not make the same election for each holding of an instrument. Dividends on those investments would also be recognised in OCI, with no subsequent recycling.

Transition

The Board reaffirmed its tentative decision to propose retrospective application but decided tentatively to propose specific transition provisions in some areas:

- the assessment of whether an instrument is 'managed on a contractual yield basis' should reflect the circumstances at the date of initial application of the revised standard.
- an entity could designate any financial instruments otherwise measured at amortised cost into the fair value option at the date of initial application if the eligibility criterion is met at that date.
- an entity would be permitted (or required if the eligibility criterion is no longer met) to dedesignate any financial instrument out of the fair value option at the date of initial application.
- if retrospective application of the impairment requirements in IAS 39 is impracticable, the fair value of the instruments measured at amortised cost should be used to determine any impairment loss in comparative

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Tel: +44 (0)20 7332 2730
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Website: www.iasb.org
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ISSN 1474-2675

periods and would be the deemed cost at the date of initial application for subsequent accounting purposes.

- if unquoted equity instruments and related derivatives were previously measured at cost, the fair value measurement requirements should be applied to them prospectively from the date of initial application with any differences recognised in retained earnings at that date.
- any required dedesignations of hedge accounting should be accounted for as a discontinuation of hedge accounting.
- those entities electing to apply the new standard early would be required to provide limited additional disclosures.
- the designation date option in IFRS 1 *First time Adoption of International Financial Reporting Standards* would remain.

Other issues

The Board decided tentatively not to propose changes in the forthcoming exposure draft on:

- the treatment of 'day 1 differences'; and
- the measurement requirements in IAS 39 for financial guarantee contracts, loan commitments and financial liabilities with demand features.

The Board also considered the interaction between this project and the annual improvements project. The Board tentatively decided to:

- to defer finalising the amendment to paragraphs AG7, proposed AG7A and IG B24 of IAS 39, on the effective interest rate.
- to finalise an amendment to AG33 of IAS 39, on the separation of an embedded foreign currency derivative.

The Board also discussed two other approaches for the classification and measurement of financial instruments that have basic loan features and are managed on a contractual yield basis. Under the first approach:

- those instruments that are assets would be eligible for measurement at amortised cost only if they are loans and receivables, as defined in IAS 39.
- those instruments that are financial liabilities would be eligible for measurement at amortised cost (assuming they would qualify for amortised cost under the new classification approach).
- if those instruments are assets that are not loans and receivables, an entity would:
  (a) measure them at fair value in the statement of financial position.
  (b) present them on an amortised cost basis in profit or loss (including recognition of impairment using the loss impairment requirements in IAS 39).
  (c) present in OCI any difference between that amortised cost amount and the fair value change. There would be no recycling between profit or loss and OCI but impairments would be reversed in profit or loss.

The second approach applies to the same instruments as the first, but differs from the first in that any difference between the amortised cost amount and the fair value change would be separately presented in profit or loss instead of OCI.

The Board decided tentatively that the exposure draft should describe these other approaches, and ask questions about them. In addition, the Board tentatively decided that the exposure draft would also refer to any proposed classification and measurement model the US Financial Accounting Standards Board (FASB) develops.

Impairment of financial assets

The Board held two education sessions on impairment of financial assets:

- *Provisioning proposal (Expected Risk Adjusted Amortised Cost)* presented by representatives from BNP Paribas.
- *Statistical provisioning* presented by representatives from the Bank of Spain.

No decisions were made.

The staff posted on the IASB website on 25 June a request for information on the feasibility of an expected cash flow approach to impairment. The Board will use the input received in developing the ED on impairment to be published later in 2009.

Conceptual framework

The Board discussed a draft measurement chapter for the conceptual framework that is based on measurement factors the Board discussed in earlier meetings. Those factors are:

- method of value realisation
- cost of preparing and using measures
- relative level of confidence in different measures
- use of consistent measures for similar items and items used together
- separability of changes in measures.

The Board decided tentatively that the measurement factors and the discussion of their relation to the objective of financial reporting and the qualitative characteristics of decision-useful information are an appropriate starting point for developing a discussion paper. The Board provided suggestions for clarifying and improving the ideas discussed in the draft chapter. The Board will continue its discussions at a future meeting, with the aim of publishing a discussion paper in the fourth quarter of 2009.

Financial instruments with characteristics of equity

The Board published the discussion paper *Financial Instruments with Characteristics of Equity* in February 2008. In October the Board decided to begin deliberations using the principles underlying the perpetual and basic ownership approaches. At this meeting the Board discussed measurement requirements for free-standing equity, liability and asset instruments and equity hybrid instruments (instruments that are separated into an equity component and a liability or asset component).

The Board made the following tentative decisions:

Transaction costs

- An entity would recognise as expense all transaction costs or fees arising from the issue of an equity instrument or equity hybrid instrument.

Initial measurement of a freestanding equity instrument

- An entity would initially measure a free-standing equity instrument at its transaction price. The transaction price does not include transaction costs or fees.

Initial measurement of the components of a separated equity hybrid instrument

- An entity would initially measure components of a separated equity hybrid instrument as follows: The liability or asset component would be measured at fair value as if it were a free-standing liability or asset. The remainder of the transaction price for the hybrid instrument as a whole would be allocated to the equity component.

Subsequent measurement of a free-standing equity instrument and an equity hybrid instrument

- An entity would not remeasure a free-standing equity instrument or equity component of a hybrid instrument that the entity cannot be required to redeem.
- At each reporting date, an entity would remeasure at current redemption value an equity instrument or a separated equity component of a hybrid instrument that has a redemption requirement. The current redemption value is the amount that would have resulted from applying the redemption formula as if redemption was required at the measurement date. Changes in current redemption value would be presented as a transfer between the redeemable equity instrument or component and another equity account.
- An entity would remeasure the liability or asset component of a separated hybrid instrument on the basis of the requirements of IFRSs that would apply if it were a freestanding instrument.

Measurement of freestanding liabilities and assets

- An entity would present a physically settled forward contract and written put options on a net basis in the statement of financial position and remeasure those instruments at fair value. Changes in fair value would be recognised in profit or loss.

Next steps

- The Board will discuss how to display in the statement of comprehensive income changes in the fair value of a non-equity instrument.

Insurance contracts

The Board continued its discussion of candidate measurement approaches for insurance contracts. The Board decided tentatively to include in the list of candidates a measurement approach based on the updated model being developed in the project to amend IAS 37 (modified to exclude day one gains).

The Board also tentatively removed the following candidates from that list:

- a fulfilment value that includes a margin for the cost of bearing risk and a residual margin (former candidate 3)
- a current exit price (modified to exclude day one gains, former candidate 1)

Next steps

The Board will continue its discussion of the candidate measurement approaches for insurance contracts, with the aim of concluding on the measurement approach in July.

The Insurance Working Group will provide input for this decision at its next public meeting, on 29 and 30 June in London.

The Board also:

- decided tentatively to perform targeted field testing of the proposals being developed.
- reviewed the timetable for the project and stressed the importance of publishing an exposure draft by the end of 2009.

Joint Ventures

The Board continued its discussion of responses to ED 9 *Joint Arrangements* and decided tentatively:

- to introduce a term such as ‘investor in a joint arrangement’ to designate parties to joint arrangements that do not have joint control in the arrangement.
- that an investor in a joint arrangement that is a joint operation should account for its assets, liabilities, revenues and expenses, including its share of any assets, liabilities, revenues and expenses arising from the joint operation.
- that an investor in a joint arrangement that is a joint venture should account for its interest in accordance with IAS 39 or, if it has significant influence in the joint venture, in accordance with IAS 28.
- that parties with interests in a joint asset should directly recognise their share of the joint asset, classified according to the nature of the asset.

The Board will continue its discussion at future meetings, with the aim of publishing an IFRS in the third quarter of 2009.

Leases

The discussion paper *Leases: Preliminary Views*, published in March 2009 presents the Board’s preliminary views on lessee accounting. However, some lessee accounting issues were left unresolved. At this meeting, the Board discussed some of those unresolved issues, including:

- sale and leaseback transactions
- impairment of right-of-use assets
- revaluation of right-of-use assets
- initial direct costs
- transition.

Sale and leaseback transactions

The Board discussed how to account for sale and leaseback transactions. In such a transaction, a seller/lessee sells an asset it owns to a buyer/lessor and then leases back that same asset.

The Board decided tentatively that the seller/lessee should:

- consider whether the entire asset qualifies for derecognition
- apply a control-based approach consistent with the revenue recognition project to determine when an asset has been sold and should be derecognised
- recognise any gain arising on a transaction that qualifies as a sale. The amount of the gain would be adjusted as appropriate if the sale proceeds or the terms of the leaseback are not at market value.

Impairment of right-of-use assets

The Board decided tentatively that lessees should refer to existing applicable impairment requirements in IAS 36 *Impairment of Assets*.

Revaluation of right-of-use assets

The Board decided tentatively that the standard applicable to the underlying leased asset would determine whether, and how, a lessee may revalue right-of-use assets. For example:

- if the underlying asset is property, plant and equipment, the lessee could revalue its right-of-use asset when IAS 16 *Property, Plant and Equipment* so permits, using the revaluation model in IAS 16.
- if the underlying asset is an intangible asset, the lessee could revalue it when IAS 38 *Intangible Assets* so permits, using the revaluation model in IAS 38.

The Board directed the staff to analyse how this conclusion would apply to investment property.

Initial direct costs

The Board discussed costs incurred by lessees when negotiating and arranging leases (initial direct costs) and decided tentatively that lessees should recognise them as an expense as incurred.

Transition

The Board decided tentatively that a lessee should recognise and measure all existing lease contracts on the date of initial application of the new standard as follows:

- the obligation to pay rentals should be measured at the present value of the lease payments, discounted using the lessee's incremental borrowing rate
- the right-of-use asset should be measured on the same basis as the liability, subject to any adjustments required to reflect impairment.

The Board directed the staff to consider whether additional adjustments to the carrying amount of the right-of-use asset should be required when lease payments are uneven over the lease term, for example if the lease includes large upfront payments, or when the entity uses a revaluation model.

Next steps

The Board will continue its discussion in July.

Liabilities – amendments to IAS 37

The Board continued its discussions on the project to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and considered:

- litigation liabilities
- reimbursement rights
- disclosure of possible obligations
- stand-ready obligations

Litigation liabilities

The Board considered concerns that defendants in legal proceedings might encounter practical problems applying the proposed recognition and measurement requirements and decided tentatively:

- not to make any changes to the proposals.
- not to amend or supplement the proposed guidance on identifying liabilities that cannot be measured reliably.
- that the proposals require no modification in this project for application in the US legal environment. The Board noted that the proposed changes to IAS 37 do not introduce any new factors that would cause problems in that environment.

Reimbursement rights

The Board discussed the measurement of reimbursement rights and decided tentatively:

- to remove the 'asset cap' from IAS 37. The 'asset cap' limits the amount recognised for a reimbursement right to the amount recognised for the related liability.
- not to specify a measurement objective for reimbursement rights.
- that the standard should state explicitly that the assumptions used to measure a reimbursement right should be consistent with those used to measure the related liability.

Disclosure of possible obligations

The Board discussed what an entity should disclose when it is uncertain whether it has a present obligation, but has judged that it does not. The Board decided tentatively:

- to help preparers identify when disclosure is required, by cross-referring from the disclosure requirement back to the discussion of uncertainty in the recognition section of the standard, and giving examples of situations involving uncertainty.
- that an entity should disclose the following, unless the possibility of any outflow of economic benefits in settlement is remote:
  (a) a description of the circumstances;
  (b) an indication of the financial effects;
  (c) an indication of uncertainties relating to the amounts or timing of any outflow of economic benefits; and
  (d) the possibility of any reimbursement.

Stand-ready obligations

The Board tentatively approved an analysis of the attributes of stand-ready obligations and the circumstances in which such obligations arise. This analysis refined an earlier analysis that the Board had considered in October 2007.

Next steps

The Board has now completed its discussions of comments on the exposure draft. At the next meeting it will consider whether any of the changes it has decided tentatively to make require re-exposure.

Rate-regulated activities

The Board finalised its discussion of issues to be included in the exposure draft on regulatory assets and liabilities and decided tentatively that:

- an entity should apply the IFRS to regulatory assets and liabilities existing at the beginning of the first comparative period presented in the annual financial statements in which the entity first applies the IFRS. Any adjustments arising on transition should be recognised in the opening balance of retained earnings.
- if amounts determined using the entity's previous GAAP would otherwise be recognised separately as regulatory assets in accordance with IFRSs, first-time adopters of

IFRSs could elect to include them in the carrying amount of property, plant and equipment or intangible assets.

- the cost of self-constructed property, plant and equipment or internally generated intangible assets should include all the amounts the regulator permits to be included in their cost, as an exception to the requirements in IAS 16 *Property, Plant and Equipment*, IAS 23 *Borrowing Costs* and IAS 38 *Intangible Assets*.
- an entity should consider the recoverability and impairment of regulatory assets by:
  (a) considering the overall effect of regulatory assets on future rates and whether recovery is reasonably assured.
  (b) if recovery is not reasonably assured, applying IAS 36 *Impairment of Assets* in testing for impairment the cash-generating unit that includes the net regulatory assets.
  (c) allocating any impairment loss to individual regulatory assets in accordance with IAS 36 by considering when, and by how much, estimated future cash flows are affected.
  (d) measuring the asset in subsequent periods using the amount and timing of the estimated cash flows used in determining the amount of the impairment loss.

The Board directed the staff to draft an exposure draft for ballot with publication expected in July.

Revenue recognition

The Board discussed:

- what amounts an entity should recognise as revenue when other parties are involved in providing goods and services to its customer
- the combination and modification of contracts
- non-monetary exchanges.

Revenues for performance by other parties

The Board decided tentatively that:

- the amount an entity recognises as revenue depends on the identification of performance obligations. In other words, the entity must determine whether its performance obligation is:
  (a) to provide goods and services, in which case the entity recognises 'gross' revenue for providing those goods and services; or
  (b) to arrange for another party to provide those goods and services, in which case the entity recognises revenue for the fee or commission.
- an entity should disclose separately revenues in the same line of business from (a) providing goods and services and (b) arranging for the provision of goods and services.
- an entity should disclose the basis for its assessment and any significant judgement in identifying performance obligations when other parties are involved in providing goods and services to the entity's customer.
- if an entity legally transfers a performance obligation to another party, so that the entity is no longer obliged to provide the underlying good or service to the customer, the entity should not recognise revenue for that performance obligation.

Combination and modification of contracts

The Board decided tentatively that:

- two or more contracts with the same customer should be accounted for as a single net contract position if the prices of those contracts are interdependent. An entity should consider various indicators and exercise judgement when determining whether prices are interdependent.
- when an entity modifies an existing contract, it should account for the modification as a separate contract if the modification is priced independently from the original contract. If the prices are interdependent, an entity should account for the original contract and modification as a single net contract position, recognising the effect of the modification on a cumulative catch-up basis.

Non-monetary exchanges

The Board previously decided tentatively that an entity should measure non-cash consideration at its fair value or, if the fair value cannot be estimated reliably, by reference to the selling price of the goods and services. It also decided tentatively that an entity should not recognise revenue if a contract lacks commercial substance.

At this meeting, the Board decided tentatively that an entity should not recognise revenue from a non-monetary exchange contract (even if it has commercial substance) if its purpose was to facilitate a sale to another party.

Annual improvements

The Board discussed five topics for possible inclusion in the exposure draft of proposed Improvements to IFRSs expected to be published in August 2009.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Revaluation basis as deemed cost

The Board decided tentatively to clarify the scope of the exemption in paragraph D8 of IFRS 1 that permits a first-time adopter to use a revaluation basis as 'deemed cost' when an event such as a privatisation triggered a revaluation at or before the date of transition to IFRSs.

The Board concluded that its reasons for granting that exemption were equally valid for similar revaluations that occurred after the date of transition to IFRSs but during the periods covered by the first IFRS financial statements. Therefore, the Board decided tentatively:

- to propose an amendment to paragraph D8 to reflect that conclusion;
- to require a first-time adopter to establish deemed cost at the date of revaluation and to present historical cost or previous GAAP amounts when so permitted by paragraphs D5-D7 for the periods before the revaluation date; and
- to permit an entity that had first applied IFRSs in an earlier period to apply this proposed amendment in the first reporting period after its effective date as if it had been available in that earlier period.

Accounting policy changes in the year of adoption

The Board decided tentatively to clarify the requirements that apply if an entity changes its accounting policies, or the IFRS 1 exemptions it chooses to apply, between the first interim financial reports it presents in accordance with IFRSs and the first annual financial statements. The Board decided tentatively that:

- IAS 8 does not apply both to the entity's selection of accounting policies at the date of transition to IFRSs and to any changes to those policies made before the date of the first annual IFRS financial statements, and
- if, during the period covered by its first IFRS financial statements, an entity changes its accounting policies or its use of the IFRS 1 exemptions, it must explain the changes and update the reconciliations of comprehensive income and equity required by IFRS 1.

IFRS 3 *Business Combinations* – Contingent consideration of an acquiree)

The Board discussed the treatment of contingent consideration arising from a prior business combination of an acquiree that an acquirer assumes in its subsequent acquisition of the acquiree ('pre-existing contingent consideration'). The Board clarified that pre-existing contingent consideration does not meet the definition of contingent consideration in the acquirer's business combination. It is one of the identifiable liabilities assumed in the subsequent acquisition. Therefore, the Board decided tentatively not to add this topic to the annual improvements project.

IAS 28 *Investments in Associates*

Venture capital consolidations and partial use of fair value through profit or loss

The Board decided tentatively to clarify that different measurement bases can be applied to portions of an investment in an associate when part of the investment is designated at initial recognition as at fair value through profit or loss in accordance with the scope exception in paragraph 1 of IAS 28.

The Board decided tentatively that an entity first determines in accordance with paragraphs 6-10 of IAS 28 whether it has significant influence over an associate. The entity measures the portion of the investment to which the scope exclusion applies at fair value through profit or loss. The remaining investment in the associate is accounted for in accordance with IAS 28.

Impairment of investments in associates

The Board decided tentatively that in its separate financial statements the investor should determine impairment of its investment in an associate in accordance with IAS 39. The Board reaffirmed its view that in separate statements, the focus is on the performance of the assets as investments. Therefore, for investments in associates accounted for either at cost or fair value through profit or loss an investor should apply IAS 39 in determining and measuring an impairment.

Future Board meetings

The Board will meet in public session on the following dates in 2009. Meetings take place in London, UK, unless otherwise noted.

20-24 July (23-24 July with FASB)

14-18 September

19-23 October

26-27 October (IASB and FASB joint meeting, Norwalk USA)

16-20 November

14-18 December