



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 18-23 April 2010. The US Financial Accounting Standards Board (FASB) joined the IASB for some sessions. The boards discussed:

- Consolidation
- Derecognition
- Financial instruments: classification and measurement
- Financial instruments: hedge accounting
- Financial statement presentation
- Insurance contracts
- Leases

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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:

4 May
17 - 21 May
14 - 18 June

To see all Board meetings for 2010, [click here](#).

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Consolidation

At their February 2010 joint board meeting, the IASB and the FASB tentatively decided that an investment company should measure its investments in entities that it controls at fair value through profit or loss.

At this meeting, the boards continued to deliberate the definition of an investment company, and tentatively decided that an investment company is an entity that meets all of the following criteria:

- *Express business purpose*. The express business purpose of an investment company is investing for current income, capital appreciation, or both.
- *Exit Strategy*. The entity has identified potential exit strategies and a defined time (or range of dates) at which it expects to exit the investment.
- *Investment activity*. Substantially all of the entity's activities are investment activities carried out for the purposes of generating current income, capital appreciation, or both. The entity and its affiliates shall not obtain benefits from its investees that would be unavailable to other investors or unrelated parties of the investee.

- *Unit ownership.* Ownership in the entity is represented by units of investments.
- *Pooling of funds.* The funds of the entity's owners are pooled so that owners can avail themselves collectively of professional investment management.
- *Fair value.* All of the investments are managed, and their performance is evaluated (both internally and externally), on a fair value basis.
- *Reporting entity.* The entity must be a reporting entity.
- *Debt.* Any providers of debt to the investees of the entity shall not have direct recourse to any of the entity's other investees.

The boards asked the staff to clarify some aspects of the criteria when they undertake further drafting. In particular, the boards asked that it should be made clear that significant third party investment is required for an entity to be an investment company. The boards also tentatively decided that the fair value measurement basis for controlled investees applied by an investment company should be retained in the consolidated financial statements of a parent of an investment company.

Transition requirements

The FASB tentatively decided that an entity currently applying the investment company guidance in Topic 946 of the Accounting Standards Codification *Financial Services - Investment Companies* should discontinue the application of this guidance if the entity no longer qualifies as an investment company. This change should be applied prospectively as from the date when the revised consolidation requirements are first applied. For those investees that are required to be consolidated as a result of an entity no longer qualifying as an investment company, the entity should apply the same transition guidance as for all other entities that will be required to be consolidated as a result of the revised consolidation requirements.

Both the IASB and the FASB tentatively decided that an entity that was not previously considered an investment company, but that meets the new definition of an investment company, should recognise its investments in entities that it controls at fair value on the date that it first applies the revised consolidation requirements, with an adjustment made to retained earnings.

Disclosure

The boards did not have the opportunity to discuss any of the consolidations papers related to disclosure. Those papers will be rescheduled.

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Derecognition

The IASB and FASB discussed the proposed derecognition model. No decisions were made. The boards will continue deliberating the derecognition model at their next joint board meeting.

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Financial instruments: classification and measurement

At previous meetings, the IASB made the tentative decision to retain the existing classification and measurement requirements in IAS 39 *Financial Instruments: Recognition and Measurement* for financial liabilities. However, the Board also tentatively decided to propose changes to the fair value option (FVO) in order to address widespread concerns about recognising gains or losses arising from changes in liabilities' credit risk.

At this meeting, the Board discussed disclosures for liabilities designated under the FVO, and the logistics for the exposure draft on financial liabilities.

Disclosures

The Board tentatively decided to propose a disclosure showing how much of the accumulated Other Comprehensive Income balance attributable to changes in own credit risk was realised during the

current reporting period.

Exposure logistics

The Board directed the staff to begin drafting the exposure draft containing the proposed changes to the FVO. The exposure draft will also ask for feedback on the Board's tentative decision that if an entity decides to adopt early any finalised requirements in the IAS 39 replacement project, the entity must also adopt early any preceding finalised guidance. The exposure draft will have a comment period of 60 days. The Board expects to publish the exposure draft in May 2010.

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Financial instruments: hedge accounting

The IASB identified the major issues that it expects to consider, and how the issues fit into the context of the overall hedge accounting model being developed. No decisions were made.

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Financial statement presentation

The IASB and FASB discussed issues that had been raised during their review of the early draft of the financial statement presentation proposals.

Unusual or infrequently occurring items

US GAAP currently requires the presentation of unusual or infrequently occurring items in the statement of comprehensive income and disclosure of related information in the notes to financial statements; however IFRS does not have similar requirements. The boards tentatively decided to include those requirements in the forthcoming exposure draft.

Guidance on classifying short-term assets and liabilities

Both US GAAP and IAS 1 *Presentation of Financial Statements* include application guidance on the classification of assets and liabilities as current (short term) or noncurrent (long term) in the statement of financial position. The boards tentatively decided not to include that application guidance in the exposure draft because the requirement in the exposure draft for classification of assets and liabilities as short term or long term should be sufficient.

Classification of debt

US GAAP and IAS 1 include different guidance for the classification of financial liabilities. The boards agreed to consider addressing those differences in a separate project. Consequently, the IASB's forthcoming exposure draft on financial statement presentation will retain the guidance in IAS 1 on classification of financial liabilities and the FASB's exposure draft will retain the classification guidance in Topic 470 *Debt* of the FASB Accounting Standards Codification™. The boards noted that any change to their existing guidance on classification of financial liabilities resulting from a potential separate project would be incorporated into the final standard on financial statement presentation.

Mixed presentation in the statement of financial position

Paragraph 65 of IAS 1 includes guidance on how an entity can use a mixed basis of presentation in the statement of financial position. This mixed basis permits some assets and liabilities to be classified using a short-term/long-long term distinction, and for other assets and liabilities to be classified in order of liquidity. The boards tentatively decided to retain that guidance in the exposure draft and to clarify its application.

Supplemental cash flow information

The boards tentatively decided that both the reconciliation of operating income and cash flows, and the presentation of non-cash transaction information should be an integral part of the statement of cash flows and not be disclosed in the notes instead.

IAS 7 paragraph 50 encourages disclosure of the following information:

- a. the amount of undrawn borrowing facilities that may be available for future business activities and to settle capital commitments
- b. the amount of cash flows that represent increases in operating capacity and the amount of cash flows that are required to maintain operating capacity
- c. the amount of cash flows arising from activities of each reportable segment.

The boards tentatively decided that the exposure draft will include (a) as a required disclosure but will not include (b) or (c). The FASB noted that as previously decided its exposure draft will require disclosure of operating cash flows by reportable segment.

Should sections and categories be in the same order on all statements?

The boards tentatively decided that the exposure draft will:

- not prescribe the order in which an entity presents its sections and categories in the financial statements; and
- clarify that an entity should try to align the sections and categories across the statements, but choose an order that produces the most understandable depiction of its activities and allows for presentation of meaningful subtotals and totals.

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Insurance contracts

Margins

The IASB and FASB discussed the two approaches to margins that the boards are considering for insurance contracts:

- a separate risk adjustment and a residual margin.
- a single composite margin.

The purpose of the discussion was to develop these approaches further. The boards intend to select one of these approaches at an additional joint board meeting on 4 May.

Risk adjustment and residual margin

The IASB and FASB provided staff with input on the objective and other draft language for the risk adjustment and asked the staff to develop further the objective and other guidance.

The boards tentatively decided that the residual margin should be part of the insurance liability, rather than a separate liability outside the insurance liability. The boards also tentatively decided that the residual margin should be disclosed separately.

The boards discussed whether interest should be accreted on the residual margins.

- The IASB tentatively decided that interest should be accreted.
- The FASB tentatively decided that interest should not be accreted.

Composite margin

The IASB and FASB tentatively agreed that, if the initial measurement of an insurance contract results in a negative day-one difference:

- The insurer should recognise that difference (loss) immediately in profit or loss.
- For this purpose, a day-one loss would arise only if, at inception, the expected present value of

the outflows exceeds the expected present value of the premiums. In other words, no separate risk adjustment would be included in determining whether there is a day-one loss under a composite margin approach.

The boards tentatively decided that the composite margin should be:

- released over both the coverage period (during which the insurer provides insurance coverage) and the claims handling period (during which the insurer is expected to pay claims).
- displayed with the insurance liability rather than as a separate liability outside the insurance liability.
- disclosed separately.

The boards asked that the staff research an approach whereby the composite margin is remeasured.

The boards also discussed whether interest should be accreted on the composite margin.

- The IASB tentatively decided that interest should be accreted.
- The FASB tentatively decided that no interest should be accreted.

Discounting

The IASB and FASB discussed the discount rate for insurance contracts and tentatively decided that the discount rate should reflect the characteristics of the contracts, rather than the characteristics of assets actually held to back the contracts, unless the contracts share those characteristics. More specifically:

- if the cash flows for the insurance contracts do not depend on the performance of specific assets, the discount rate should be a risk-free rate plus an adjustment for illiquidity.
- if the amount, timing or uncertainty of cash flows for the insurance contracts depends, wholly or partly, on the performance of specific assets, the measurement of these contracts should consider that fact

The boards asked the staff to incorporate the existing requirements on discount rates from other standards when developing guidance for estimating a discount rate for insurance contracts. For example, the guidance should specify that the discount rate should not include any risk that is included in other parts of the measurement.

During the discussion the boards considered concerns raised by some commentators about the discount rate, particularly for long-duration non-participating insurance contracts. Those concerns include the possibility of significant losses at the inception of some contracts and possible accounting mismatches if the discount rate for insurance contracts does not change in response to changes in market credit spreads.

The boards discussed whether these concerns would diminish if the boards revisited their previous tentative decision that the measurement of an insurance liability should not be updated for changes in the risk of non-performance by the insurer. After the discussion, the boards did not change that tentative decision but they decided that the forthcoming exposure draft on Insurance Contracts should ask for specific input on this issue.

Contract boundary

The IASB discussed what conditions determine the boundary of an insurance contract. The Board tentatively decided that the boundary of an insurance contract is the point at which the insurer either:

- is no longer required to provide coverage; or
- has the right to reassess the risk of the particular policyholder and, as a result, can set a price that fully reflects that risk.

Recognition

The IASB discussed the recognition criteria for an insurance contract. The Board agreed in principle

that the insurer should recognise the rights and obligations arising from an insurance contract on the earlier of:

- the insurer being on risk to provide coverage to the policyholder for insured events; and
- the signing of the insurance contract.

The Board asked the staff to refine those criteria.

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Leases

Accounting for sale and leaseback transactions

The IASB and FASB tentatively decided that a sale and leaseback transaction should be accounted for as a sale and leaseback, rather than as a financing, if it is determined that the underlying asset has been sold. The underlying asset has been sold if, at the end of the contract, control of the underlying asset has been transferred, and if all but a trivial amount of the risks and benefits associated with the underlying asset have been transferred to the buyer/lessor.

The boards also tentatively decided that if a sale and leaseback transaction results in a sale of the underlying asset, and if both the sale and the leaseback are established at fair value, gains or losses arising from the transaction should not be deferred. If the sale or the leaseback is not established at fair value, an entity should adjust the asset, liabilities, gains, and losses that have been recognised, to reflect current market rentals.

Lessor accounting for the performance obligation

The IASB and FASB tentatively decided that the amortisation of the performance obligation should be performed in a systematic and rational manner, based on the pattern of use of the underlying asset by the lessee (for example, over time, based on hours of use, etc.). The boards instructed the staff to provide additional analysis on when and how revenue should be recognised upon lease commencement.

Accounting for subleases

The IASB and FASB tentatively decided that:

- An intermediate lessor, as a lessee in a head lease, should account for its assets and liabilities arising from the head lease in accordance with the lessee model developed by the boards. Similarly, the intermediate lessor, as a lessor in a sublease, should account for its assets and liabilities arising from the sublease in accordance with the lessor model developed by the boards.
- Intermediate lessors should present all assets and liabilities arising from lease contracts with subleases, excluding their obligation to pay rentals to the head lessor, together in the statement of financial position, gross with a net subtotal. The obligation to pay rentals to the head lessor should be presented separately.
- Intermediate lessors should disclose in their financial statements the nature and amount of significant subleases.

Lessor accounting for impairment of assets

The IASB and FASB discussed impairment of assets under the performance obligation approach to lessor accounting. The boards instructed the staff to develop a flowchart to show how the interrelationship between the lease receivable, the performance obligation, and the underlying asset would be assessed for impairment.

Accounting for long-term leases of land

The IASB and FASB tentatively decided that long-term leases of land would not be excluded from the scope of the proposed new leases requirements for lessees and lessors.

Lessor accounting for purchase options

The IASB and FASB tentatively decided that purchase options would be accounted for by lessors in the same way as lessors account for renewal or termination options. Consequently:

- Purchase options would not be recognised as separate assets.
- A lessor's receivable and performance obligation would be measured on the basis of the lease payments that would be received; the lessor would therefore decide whether it is more likely than not that an option to purchase will be exercised. If the lessor decides that the option to purchase is more likely than not to be exercised, the lease receivable would include the exercise price of the purchase option.
- The exercise of the purchase option would be reassessed at each reporting date. Detailed examination of every lease would not be required unless there is a change in facts or circumstances that would indicate that the purchase option would be exercised.
- Any change to the lease receivable resulting from a reassessment of the exercise of a purchase option would be recognised as an adjustment to the performance obligation.
- The lessor's performance obligation relating to rental payments would be recognised in income over the lease term in a manner that depicts the consumption pattern of the underlying asset that the lessor is providing to the lessee. The lessor's performance obligation relating to the purchase option would not be recognised in income until the purchase option is exercised.

Lessee presentation of total cash rentals paid

The IASB and FASB tentatively decided that no additional disclosures of the total cash rentals paid would be required on the face of the financial statements. That information would be disclosed in the notes to the financial statements for each period presented, as part of the reconciliation between the opening and closing balances for the lessee's obligation to pay rentals.

First time adoption under the proposed new leases requirements

The IASB tentatively decided that:

- First-time adopters of IFRSs should apply the same proposed transitional requirements as do other lessees and lessors. That is, lease assets and liabilities should be recognised and measured at the present value of the lease payments for all leases
- A first-time adopter should not apply the relief for simple finance leases. Instead, simple finance leases should be accounted for in the same way as all other leases are on first-time adoption.

Consequential amendment to IFRS 3 Business Combinations

The IASB tentatively decided that at the acquisition date, the acquirer would measure the acquired lease asset and liability in accordance with the proposed leases requirements. Fair value measurement at the acquisition date would not be required.

Consequential amendment to IAS 40 Investment Property

The IASB tentatively decided that:

- If an entity elects to use the fair value model, its right-of-use asset classified as an investment property is subsequently measured at fair value in accordance with IAS 40 *Investment Property*. Consequently, the new lessee accounting requirements on subsequent measurement would not be required
- If an entity elects to use the cost model, the new lessee accounting requirements for right-of-use assets would be required. Consequently, the requirement under IAS 40 to subsequently measure investment property at depreciated cost using the cost models in IAS 16 *Property, Plant and Equipment* would be replaced with the new lessee accounting requirements
- If the right-of-use asset is measured at fair value, adjustments to the obligation to pay rentals arising from changes in the lease term or from changes to estimated contingent rentals would be

recognised in profit or loss.

Revaluation of the right-of-use assets

The IASB tentatively decided that:

- A lessee should be permitted to revalue its right-of-use assets even if there is no active market in the right-of-use assets.
- If the lessee chooses to revalue its owned assets in a class of property, plant and equipment, a lessee should be permitted to revalue its leased assets (right-of-use assets).
- A lessee should be required to revalue the entire class of property, plant and equipment (comprising all owned and leased assets) to which that leased asset belongs if the lessee chooses to revalue its leased assets.

Lessor disclosure requirements

The IASB and FASB tentatively approved a set of disclosure requirements for the forthcoming Exposure Draft.

An entity would disclose the quantitative and qualitative financial information that:

- identifies and explains the amounts recognised in its financial statements arising from lease contracts
- enables users to evaluate the nature and extent of the amount, timing, and uncertainty of cash flows arising from lease contracts and how the entity manages those cash flows.

These disclosures would include:

- The nature of the lease arrangement, if leasing arrangements are a significant part of the lessor's business activities in terms of revenue, net income, or assets, disaggregated (for example, by nature or function), including:
 - a. A general description of those leasing arrangements
 - b. The existence and terms of renewal, termination, and purchase options
 - c. A description of how the effect of contingent rentals on the carrying amounts of the lease receivable and performance obligation is determined
 - d. Initial direct costs incurred.
- In addition to the disclosures already required for the leased asset, a description of any restrictions placed on leased assets as a result of any lease arrangements and a description of the existence and terms of any residual value guarantees.
- For its lease receivables, a maturity analysis on an annual basis for the first five years, and a lump sum for the remaining amounts, comparing the potential differences in cash flow attributable to those that are the minimum contractual receivables and those that are the total estimated lease receivable. A lessor would not be required to disclose the fair value of its lease receivable.
- The disclosures required by the Revenue Recognition project for its performance obligations. For example, a lessor would disclose a maturity analysis surrounding the satisfaction of performance obligations. For all remaining performance obligations in contracts expected to be completed after one year from contract inception, an entity would disclose the amount of the transaction price allocated to the performance obligations that are expected to be satisfied between one and two years, between two and three years, and after three years from the end of the reporting period.
- A reconciliation between opening and closing balances for its receivable and its performance obligation. That reconciliation would follow the disaggregation principle in the Financial Statement Presentation project to provide useful information. The boards asked the staff to consider whether changes (for example, increases and decreases attributable to changes in estimates due to options, contingent rents, and residual value guarantees) should be shown gross or net.
- For IFRS preparers, information relating to risks surrounding a lease receivable in accordance with IFRS 7 *Financial Instruments: Disclosures*, and for U.S. GAAP preparers, information in accordance with the proposed Accounting Standard Update relating to credit quality upon final

issuance to help users to evaluate the nature and extent of the amount, timing, and uncertainty of future cash flows arising from lease contracts, and the way in which the lessor manages those uncertainties.

- The fact that a lessor has applied a simplified form of lease accounting for short-term leases, if applicable. The lessor would also disclose the gross amount recognised in the statement of financial position that was accounted for under the simplified accounting model.

Lessor accounting for impairment of assets

The IASB and FASB discussed impairment of assets under the performance obligation approach to lessor accounting and tentatively decided that the lease receivable would first be evaluated for impairment. Any impairment to the lease receivable would result in an adjustment to the lease receivable and the performance obligation, with any difference being recognised in profit or loss. Lessors would also have to evaluate their leased asset for impairment. The boards instructed the staff to consider further how the underlying asset would be assessed for impairment under IAS 36 Impairment of Assets, and the impairment guidance in Topic 360 *Property, Plant and Equipment* of the FASB Accounting Standards Codification™.

The boards will continue discussion of lessee and lessor accounting at their May 2010 meeting.

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