IASB Update

From the International Accounting Standards Board

September 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 14 - 16 September 2010. The US Financial Accounting Standards Board (FASB) joined the IASB for some sessions. The topics discussed were:

- Annual improvements
- Asset and liability offsetting
- Emissions trading schemes
- Fair value measurement
- Fair value option for financial liabilities
- Financial instruments: hedge accounting
- Financial instruments: impairment
- Financial instruments with characteristics of equity
- IFRS 1 *First-time Adoption of International Financial Reporting Standards* - severe hyperinflation
- IFRS Interpretations Committee - IFRS 2 *Share-based Payment* - Vesting and non-vesting conditions
- IFRS Interpretations Committee - Put on non-controlling interests
- IFRS Interpretations Committee - update from last meeting
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- Management commentary
- Post-employment benefits
- Rate-regulated activities

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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:

24 September
5 October
18 - 22 October
25-27 October
15 - 19 November (Norwalk, US)

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

Archive of IASB Update Newsletter

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

Podcast summaries

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

Annual improvements

The Board discussed one issue that the IFRS Interpretations Committee had recommended that the Board should include within the next *Improvements to IFRSs* exposure draft.

IAS 1 *Presentation of Financial Statements* - Comparatives in financial statements

The Board discussed the inclusion in Annual Improvements of a proposed amendment to IAS 1 to clarify the requirements that relate to comparative information. The proposed changes were tentatively approved at the Board meeting in March 2010 as part of the discussions on the Financial Statement Presentation project.

The proposed change would be to clarify that required comparative information in paragraphs 38 to 40 of IAS 1 is part of a complete set of financial statements and to make clear the minimum requirements for comparative information.

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

Asset and liability offsetting

The IASB and FASB discussed whether and when offsetting of financial assets and liabilities in the statement of financial position provides useful information or is appropriate.

The boards concluded that the following factors may be helpful in determining when offsetting provides useful information or is appropriate, and that those factors should be considered in determining the basis for offsetting of financial assets and liabilities in the statement of financial position:

- whether the parties need to have the ability to offset or settle net
- whether the parties need to demonstrate an intent to settle net
- whether the amounts owed under the respective contracts ought to be settled on the same date or be settled simultaneously
- whether the financial asset and liability ought to have the same maturity
- whether the financial asset and liability ought to have the same underlying risk
- whether offsetting should be on the basis of bilateral or multilateral netting arrangements.

The boards will discuss these factors at a future meeting. No decisions were made.

Emissions trading schemes

The IASB and FASB discussed the initial accounting issues in a cap and trade scheme. Specifically, the boards discussed the issues of recognition of allowances as assets, and the existence and recognition of liabilities when allowances are allocated.

A cap and trade scheme is one type of emission trading scheme. In a cap and trade scheme, an entity may receive an allowance from the scheme administrator for no monetary consideration. The Agenda Papers describe this as an allocation of allowances. The issues of whether allowances can be recognised as assets and whether a liability exists when an entity receives an allocation of allowances are critical issues in determining the accounting for a cap and trade scheme.

The FASB and the IASB tentatively decided that purchased and allocated allowances should be recognised as assets.

The boards tentatively decided that a liability exists when the allowances are allocated because the definition of a liability is met. The obligating event in this case is the allocation of allowances. The boards discussed the liability in the context of three views outlined in IASB Agenda Paper 10B, which was also issued as FASB Agenda Paper 6B. The IASB expressed support for the view that when an entity is allocated allowances, it has an obligation to comply with the scheme requirements: to refrain from emitting to keep the allowances, or to return them. However, Board members provided suggestions for refining the description of the view. Although the FASB decided that a liability exists upon the allocation of the allowances, the FASB did not have majority support for any of the views as described in the paper.

Next steps

At future board meetings, the boards will discuss the issues of measurement and presentation (including netting) and whether a right to future allocations can be recognised as an asset.

Fair value measurement

The boards discussed the comment letters received on the FASB's exposure draft of proposed amendments to Topic 820 *Fair Value Measurements and Disclosures* and the IASB's re-exposure of the measurement uncertainty analysis disclosure. The comment deadline was 7 September 2010.

The boards also discussed the preliminary project plan. In October 2010, the boards will resume their discussions on the issues raised in the comment letters. The boards plan to issue a common fair value measurement standard in the first quarter of 2011.

The boards did not make any technical decisions at this meeting.

Fair value option for financial liabilities

The Board discussed whether the effects of changes in a liability's credit risk should affect profit or loss and how to determine the effects of changes in a liability's credit risk.

The comment period for the exposure draft (ED) *Fair Value Option for Financial Liabilities* ended in July 2010. At the July meeting the Board discussed a summary analysis of the comment letters received.

At this meeting, the Board began re-deliberating the issues in the ED and made the following tentative decisions.

- For all liabilities designated under the fair value option, the effects of changes in a liability's credit risk will be required to be presented in other comprehensive income unless such treatment would create a mismatch in profit or loss. If such a mismatch would be created, the entire fair value change would be required to be presented in profit or loss. To make that determination about mismatches, an entity would assess whether it expects that the effects of changes in the liability's credit risk will be offset in profit or loss by a change in the fair value of an asset. An entity would make that determination at initial recognition and it would not be reassessed. An entity will be required to disclose the basis for its determination in the notes to the financial statements and to apply it consistently.
- The guidance in IFRS 7 *Financial Instruments: Disclosures* will be used for the purposes of determining the amount of change in a liability's fair value that is attributable to changes in its credit risk, with some additional examples and guidance.

Financial instruments: hedge accounting

Eligibility of groups of hedged items

The staff presented a summary of the Board's tentative decisions to date on the eligibility of groups of hedged items, including net positions. The staff also summarised concerns that had been expressed by various Board members about the staff's responses to those concerns.

The purpose of this summary was to allow the Board to see how their tentative decisions interact and how their concerns were being addressed.

The Board tentatively decided that the proposed general hedge accounting model should include some criteria restricting the eligibility of cash flow hedges of net positions in some circumstances. The Board requested the staff to produce more examples to help determine what restrictions are necessary.

Portfolio fair value hedge accounting for interest rate risk

The staff presented the Board with a summary of hedge accounting issues arising from portfolio fair value hedging fixed rate debt instruments for interest rate risk. The Board will continue their discussions on this topic at a future meeting and did not make any decisions.

Measurement of hedge ineffectiveness

The Board tentatively decided that the principle in IAS 39 *Financial Instruments: Recognition and Measurement*, that all hedge ineffectiveness should be measured and recognised, should remain in the hedge accounting approach the Board is developing. Hedge ineffectiveness would be determined using a 'dollar-offset' approach.

The Board also tentatively decided that measurement of ineffectiveness should be based on the actual performance of the hedged item and hedging instrument, including the effects of the time value of money.

The Board also tentatively decided that guidance about the use of a 'hypothetical derivative' to measure the present value of the expected future cash flows of the hedged item. The hypothetical derivative is then used as an input to a hedge effectiveness testing method or for measuring hedge ineffectiveness and the guidance should be improved.

Presentation: basis adjustments and hedging FX risk of firm commitments

The Board discussed 'basis adjustments' for hedges of forecast transactions (the adjustment of the initial carrying amount of a non-financial item for the hedging gain or loss) and the interaction with the hedge accounting mechanism for hedges of FX risk of firm commitments (the choice between a fair value or cash flow hedge).

The Board tentatively decided to replace the accounting policy choice that is in IAS 39 *Financial Instruments: Recognition and Measurement* and and require entities to adjust the initial carrying amount of the hedged item for the hedging gain or loss (basis adjustment).

The Board also tentatively decided to continue to permit the accounting choice that is in IAS 39 and allow hedges of FX risk of a firm commitment to be accounted for as a fair value hedge or as a cash flow hedge.

Scope of hedge accounting disclosures

During the staff's outreach activities on hedge accounting, users of financial statements have indicated that it is important for them to have information on the risks that an entity is exposed to and on how those risks are being managed.

To enable the staff to develop proposals for hedge accounting disclosures, the Board first had to determine what type of information would fall within the scope of such disclosures.

The Board tentatively decided that, in developing possible disclosures, the staff would follow an approach whereby:

- disclosures in IFRS 7 *Financial Instruments: Disclosures* are expanded to include the exposure to a specific risk for financial and non-financial items when an entity applies hedge accounting; and
- hedge accounting disclosures are restricted to the risks that an entity is exposed to that are tracked as part of the risk management process.

Financial instruments: impairment

At this meeting, the Board continued its redeliberations on phase II of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The Board continued its discussions in the context of open portfolios of financial assets, and will consider any specific issues for individual financial assets after a general impairment model for open portfolios has been developed.

Treatment of initial expected loss (EL) estimates

At this meeting, the Board discussed the broad approaches for the treatment of initial EL estimates. The two alternatives were to:

- recognise the entire lifetime EL in the first period; or
- allocate the lifetime EL over the life of the portfolio.

The Board tentatively decided to proceed with developing an approach that allocates the lifetime EL over the life of the portfolio.

Allocating the EL over the life of the portfolio

On the basis of the tentative decision to allocate the lifetime EL over the life of the portfolio, the Board then discussed whether to allocate the lifetime EL using an integrated or non-integrated (ie 'decoupled') effective interest rate.

The Board tentatively decided to permit the use of a 'decoupled' effective interest rate (ie the EL estimate and effective interest rate are calculated and accounted for separately over the life of the portfolio). The Board agreed that 'decoupling' the effective interest rate was one way to make the EL approach to impairment more operational than the integrated effective interest rate that had originally been proposed in the exposure draft.

The IASB and FASB also held an education session as preparation for their joint discussions, which will begin once the comment period on the FASB FI proposals closes.

Financial instruments with characteristics of equity

The Board discussed the next steps in the project, specifically whether it should continue to pursue the approach proposed in the staff draft of the exposure draft *Financial Instruments with Characteristics of Equity* or another approach. The Board discussed the following possible ways forward:

a. amend the requirements in IAS 32 *Financial Instruments: Presentation* to address specific practice problems and pursue adopting the amended version in the United States,
b. make targeted improvements to US GAAP and IFRS to increase convergence between the two sets of accounting standards,
c. pursue a narrow view of equity,
d. defer the project until some of the other projects on the Board's agenda are completed, or
e. continue working on the proposed approach.

The Board tentatively decided against pursuing alternatives (c), (d) or (e). The Board expects to discuss alternatives (a) and (b) with the FASB at a joint meeting in October.

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

The IASB discussed additional work performed by the staff on a recommendation by the IFRS Interpretations Committee to amend IFRSs to clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because it had a functional currency that was subject to severe hyperinflation.

In these discussions, the IASB noted that the issue is:

- different from other concerns relating to the scope of IAS 29 *Financial Reporting in Hyperinflationary Economies* that have been raised by interested parties; and
- of greater significance to entities that are subject to severe hyperinflation than for entities with an interest in an entity that is subject to severe hyperinflation. Entities with an interest in an entity that is subject to severe hyperinflation have generally been able to find appropriate existing guidance in IFRSs.

Consequently, the IASB tentatively decided to amend IFRS 1 by providing an exemption that could be used when an entity resumes presenting financial statements in accordance with IFRSs after being subject to severe hyperinflation. This exemption would allow an entity to elect to measure assets and liabilities at fair value, and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

The IASB requested that the basis for conclusions should reflect that:

- the exemption is an election and that an entity may apply other guidance in IFRS 1 when measuring assets and liabilities in the opening IFRS statement of financial position; and
- the amendment does not provide guidance for entities affected by severe hyperinflation that are not within the scope of IFRS 1. Specifically, the Board did not make any tentative decisions on how, in the consolidated financial statements of parents, venturers and investors with an interest in an entity that was subject to severe hyperinflation, an entity should account for that interest.

The Board tentatively decided to publish an exposure draft with a 60-day comment period so that the guidance may be available on a timely basis for those jurisdictions that are currently affected by the issue.

IFRS Interpretations Committee - IFRS 2 *Share-based Payment* - Vesting and non-vesting conditions

The Board discussed several paths forward for the Interpretations Committee's active agenda project Vesting and Non-vesting Conditions. The Board did not support the amendments as proposed. The Board asked the Interpretations Committee to consider whether any of the issues being addressed could be dealt with as annual improvements. The Board also asked the Interpretations Committee to review the other requests that it had received in relation to IFRS 2 with a view to helping the staff to develop an agenda proposal that could be considered as part of the setting of the new agenda in 2011.

IFRS Interpretations Committee - Put on non-controlling interests

The Board was provided with a summary of the matters arising from the IFRS Interpretations Committee's discussions relating to the accounting for a put option, written over shares held by a non-controlling interest shareholder ('NCI puts').

The Board observed that the IFRS Interpretations Committee had tentatively decided not to add these issues to its agenda but to recommend that the Board should address accounting concerns relating to NCI puts as part of the Financial Instruments with Characteristics of Equity (FICE) project. The Board will consider addressing the accounting for NCI puts as part of the FICE project.

IFRS Interpretations Committee: update from last meeting

The Board discussed the IFRS Interpretations Committee's meeting on 2 and 3 September 2010. Details of the meeting were published in IFRIC Update, available **here**.

Liabilities - IFRS to replace IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

The IASB considered a summary of comments received on the exposure draft *Measurement of Liabilities in IAS 37*.

The comments reinforced those that the Board had received while interacting with respondents and other interested parties during the comment period. In particular, respondents argued that:

- the 'expected value' of a single liability (the probability-weighted average of the range of possible outflows) is a less relevant measure of the liability than the most likely outflows.
- entities cannot measure reliably the expected values of some liabilities within the scope of IAS 37 - in particular some liabilities arising in legal disputes.
- the reasons for adding a risk adjustment-and the way in which an entity would measure the adjustment-are unclear. As a consequence, measurements that include risk adjustments might not be reliable or comparable.
- contractor prices are not relevant measures of the entity's future outflows, and, in the absence of a market, cannot be estimated reliably.
- the recognition criteria are unclear and would be difficult to apply - especially in situations (such as legal disputes) in which there is uncertainty about whether a liability exists.
- the proposals would be difficult to apply in the US legal environment.
- overall, the proposals would not improve IAS 37, which some respondents think works well in practice.
- given the time that has elapsed since the 2005 exposure draft, and the relationship between the proposed measurement requirements and other sections of the draft IFRS, the Board should re-expose the entire IFRS.

The Board decided to continue its deliberations on this project to replace IAS 37 on the grounds that parts of that standard are causing diversity in practice and need amendment. The Board expressed a willingness to consider ways of addressing the matters raised by respondents and will continue to interact with respondents.

The staff presented a plan identifying specific suggestions for further consideration by the Board. The plan would involve:

- considering whether to introduce different requirements for liabilities whose expected values cannot be measured reliably. One approach might be to specify simplified measurement techniques. Another approach might be to specify that the liabilities should not be recognised at all because they do not satisfy the 'reliable measurement' recognition criterion. Entities would instead disclose clearly the existence of, and information about, the unrecognised liabilities.
- considering adding more guidance to help entities decide whether they have a liability to recognise. One possible source for such guidance could be the **staff paper *Recognising Liabilities arising from Lawsuits***, posted on the IASB's website in April 2010.
- reconsidering the requirement to identify the *lowest* of the fulfilment, transfer and cancellation prices.
- reconsidering the requirement to add a risk adjustment.
- reconsidering the requirement to measure future outflows by reference to contractor prices.
- considering whether to add more guidance on various other matters, such as discount rates (whether they should include non-performance risk), disclosure requirements, contingent assets and onerous contracts.

The Board also tentatively decided that, once it has reached decisions on the matters raised by respondents, any revised draft IFRS would be exposed in its entirety for further comment. The Board expressed a desire to avoid unnecessary delay, but noted that, because of other priorities and the need to give proper consideration to the matters raised by respondents, it may not be able to issue an exposure draft before the second half of 2011.

Management commentary

The Board instructed the staff to begin the process to publish the final document for management commentary. The exposure draft *Management Commentary* was published in June 2009. The final document will be an IFRS Practice Statement, and, as originally proposed, will not be a standard. Accordingly, an entity will not be required to comply with the final document to be able to assert compliance with IFRSs.

The final document, to be titled 'IFRS Practice Statement *Management Commentary*', is expected to be published in October 2010.

Post-employment benefits

The Board considered a project plan and a high-level summary of the main messages received from outreach activities on its exposure draft *Defined Benefit Plans*.

No decisions were made. At the next meeting the Board intends to discuss a summary of comment letters received, the project scope, recognition and presentation.

Rate-regulated activities

At its September 2010 meeting, the Board continued its discussions on rate-regulated activities. The Board received papers that focused on:

- whether the effect of regulators should be analysed in the context of IAS 38 *Intangible Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- whether the effect of regulators should be recognised in financial statements that are prepared in accordance with existing IFRSs.
- the status of the Rate-regulated Activities project as a stand-alone project.
- whether IFRSs should be amended to require specific disclosure requirements related to the impact of regulations on an entity that is subject to regulations.

The Board did not reach conclusions on any technical issues at this meeting.

The Board reconfirmed its earlier view that the matter could not be resolved quickly. Accordingly the Board decided that the next step should be to consider whether to include rate regulated activities in its future agenda.

The Board therefore decided to include in its public consultation on its future agenda a request for views on what form a future project might take, if any, to address rate-regulated activities. The feedback received will assist the Board in setting its future agenda. The potential future steps include, but are not limited to:

- a disclosure only standard
- an interim standard, similar to IFRS 4 *Insurance Contracts* or IFRS 6 *Exploration for and Evaluation of Mineral Resources*, to grandfather previous GAAP accounting practices with some limited improvements
- a medium term project focused on the effects of rate-regulation
- a comprehensive project on intangible assets.

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