

## Staff Paper

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Topic

### **Progress report on IASB-FASB convergence work**

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1. On 21 April 2011, the IASB and FASB published a progress report on their joint work to improve International Financial Reporting Standards and US generally accepted accounting practices, and to bring about their convergence. This paper reproduces that report.
2. We provide a progress report on the insurance contracts project in agenda paper 2.

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This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB Insurance Working Group.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

The meeting at which this paper is discussed is a public meeting but it is not a decision-making meeting of the Board.

Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

# Progress report on IASB-FASB convergence work

20 April 2011

In a joint Statement issued in November 2009 we, the International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB), reaffirmed our commitment to improving International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP) and achieving their convergence. We set out our plans for completing the major projects in our Memorandum of Understanding (MoU) issued in 2006 (updated in 2008) and committed to provide transparency and accountability by reporting periodically on our progress towards achieving those goals. This is our fourth progress report and it reflects the status of our work plan as of the date of this report.

Our last progress report, given on 29 November 2010, affirmed the changes that we made to our work plan in June 2010 to allow for broad-based and effective stakeholder outreach, which is critical to the quality of our standards. That plan gave priority to the major MoU projects for which we believe the need for improvement of IFRSs and US GAAP is the most urgent. Those priority projects include our joint projects on financial instruments, revenue recognition, leasing, insurance contracts, the presentation of other comprehensive income, fair value measurement, and the consolidation of investment companies. In addition, the IASB also assigned priority to improved disclosures about derecognised assets and other off balance sheet risks (aligning with recently issued US GAAP requirements) and consolidations (particularly in relation to structured entities).

Following their joint meeting in London on 11-14 April 2011, the boards are providing this report on the progress of their joint convergence work. Since their report last November, the IASB and the FASB have taken the following actions:

1. **Completed five projects:** The boards have reached important decisions on a number of projects, reducing the number of remaining priority MoU projects to three (revenue recognition, leasing and financial instruments) for continued work. Reflecting the completion of MoU projects, publication of standards that are converged or substantially converged on fair value measurement, consolidated financial statements (including disclosure of interests in other entities), joint arrangements, other comprehensive income and post-employment benefits is expected in the coming weeks.
2. **Priority given to the remaining MoU areas and insurance accounting:** In November 2010 the boards decided to give priority to their joint work on three MoU projects—financial instruments, revenue recognition and leases—and accounting for insurance contracts in order to permit timely completion.

3. **Extended the completion target beyond June 2011:** At their meeting in April, the boards extended the timetable for the remaining priority MoU convergence projects and insurance beyond June 2011 to permit further work and consultation with stakeholders. The boards have revised their work plan by planning to complete the three remaining priority convergence projects in the second half of 2011, in a manner consistent with an open and inclusive due process. For insurance contracts, the IASB plans to complete its project in the second half of 2011 while the FASB plans to issue an exposure draft in a similar timeframe. This work plan is described in more detail below.
4. **Agreed that the decisions that will be made on effective dates will give entities sufficient time to implement changes:** The boards have emphasised that they will set effective dates that will allow those who use IFRSs and US GAAP adequate time to prepare for implementation of the standards.

### *Completion of MoU work*

With the progress made since the last report, the boards are nearing the completion of their MoU programme, which began in 2002:

- The short-term projects identified for action in their 2006 MoU and updated 2008 MoU have been completed or are close to completion.
- Of the longer-term projects, only three of the priority convergence projects remain for which the boards have yet to finalise the technical decisions—**financial instruments, revenue recognition and leasing**.

For a summary of work completed from the original publication of the MoU in 2006, please see Appendix A.

### *Priority and timing of the remaining convergence work*

Three years ago the boards set, with support from the international community, the target date of 30 June 2011 to finalise the MoU projects. Setting that target date has been instrumental in getting the boards to this point—the near final stages of completing new standards that they expect will bring significant improvements to financial reporting.

At their meeting in April, the boards agreed that they will spend additional time beyond June 2011 to complete this joint work. The boards are committed to the goal of completing the work in the remaining MoU areas expeditiously during the second half of 2011. This objective is consistent with the recommendations of G20 leaders made at the Toronto summit.

The boards will use the additional time to consult those affected by the proposed changes and work through concerns and issues being raised by stakeholders. Before each standard is issued, the boards will consider:

- whether re-exposure is necessary; and
- whether they have undertaken sufficient outreach on the proposed standard to assure the boards that the proposed standard is operational and will bring improvements to financial reporting.

In October last year the boards published documents seeking views on ways to reduce the costs of applying new requirements, focusing on the potential effective dates and transition and whether early adoption should be permitted. The objective of both boards is to ensure that stakeholders have sufficient time to prepare for any new requirements.

To provide additional assurance, the Trustees of the IFRS Foundation are undertaking an enhanced oversight process between its Due Process Oversight Committee and the IASB to ensure that the IASB is meeting its due process requirements. The FASB's due process is also subject to oversight by its Board of Trustees as well as its Standard-setting Process Oversight Committee.

Specific details regarding the proposed work plan for each of the remaining projects are explained in Appendix B.

## Appendix A—Status of convergence work

### *Short-term convergence work*

Most of the short-term projects required one of the boards to revise its requirements to align them with those of the other board. Other projects, such as share-based payment, required both boards to issue revised standards.

	<b>Project</b>	<b>Status</b>	<b>Milestone</b>
1	<b>Share-based payments</b>	Completed	Substantially converged standards issued in 2004.
2	<b>Segment reporting</b>	Completed	IFRS 8 <i>Operating Segments</i> issued in 2006.
3	<b>Non-monetary assets</b>	Completed	FASB converged on the treatment of certain non-monetary exchanges to require recognition at fair value unless the transaction lacks commercial substance in FAS 153, <i>Nonmonetary Assets</i> issued in 2004.
4	<b>Inventory accounting</b>	Completed	FASB converged on the treatment of excess freight and spoilage in FAS 151, <i>Inventory Costs</i> issued in 2004.
5	<b>Accounting changes</b>	Completed	FASB converged on the treatment of voluntary changes in accounting policy by requiring retrospective application in FAS 154, <i>Accounting Changes and Error Corrections</i> issued in 2005.
6	<b>Fair value option</b>	Completed	FAS 159, <i>The Fair Value Option for Financial Assets and Financial Liabilities</i> , issued in 2007, introducing the fair value option into US GAAP.
7	<b>Borrowing costs</b>	Completed	Revised IAS 23 <i>Borrowing Costs</i> in 2007.
8	<b>Research Costs</b>	Completed	FAS 141R, <i>Business Combinations</i> issued in 2008, amending the accounting for acquired R&D.
9	<b>Non-controlling interests</b>	Completed	FAS 160, <i>Noncontrolling Interests in Consolidated Financial Statements</i> , issued in 2008, eliminating the use of mezzanine presentation of non-controlling interests.
10	<b>Joint ventures</b>	Final stages —IFRS to be published in May 2011.	IFRS 11 <i>Joint Arrangements</i> to be issued in May 2011.

	<b>Project</b>	<b>Status</b>	<b>Milestone</b>
11	<b>Income tax</b>	Reassessed as a lower priority project. No immediate action.	IASB exposure draft published in 2009.
12	<b>Investment properties</b>	In process.	The FASB is developing proposals to align US GAAP with IFRSs.

The boards also have a project in progress to develop a joint *Conceptual Framework for Financial Reporting*. In 2010 the boards published chapters on objectives and qualitative characteristics.

### ***Memorandum of Understanding projects***

With the exception of the three remaining priority MoU projects, the following schedule details the progress of the IASB and the FASB MoU projects:

	<b>Project</b>	<b>Status</b>	<b>Milestone</b>
1	<b>Business combinations</b>	Completed	Joint requirements for business combination accounting and non-controlling interests issued in 2008.
2	<b>Derecognition</b>	Completed	Each board has introduced reforms substantially aligning the disclosure requirements and bringing US GAAP accounting requirements closer to IFRSs.
3	<b>Consolidated financial statements</b> (including disclosure about off balance sheet risks)	Final stages —IFRS to be issued in May 2011. FASB to expose proposals in relation to variable interest entities in May.	IFRS 10 <i>Consolidated Financial Statements</i> and IFRS 12 <i>Disclosure of Interests in Other Entities</i> to be issued in May 2011. The new IFRSs improve the accounting and disclosure for special purpose entities and substantially align the accounting and disclosure requirements for special purpose entities with US GAAP.
4	<b>Fair value measurement</b>	Final stages —IFRS and FASB revisions to be issued in [April] 2011.	FASB Statement No. 157 <i>Fair Value Measurements</i> issued in 2006. IFRS 13 <i>Fair Value Measurement</i> to be issued in [April] 2011.
5	<b>Post-employment benefits</b>	Final stages—IFRS to be issued in May 2011.	Amendments to IAS 19 <i>Employee Benefits</i> to be issued in May 2011.

6	<b>Financial statement presentation—other comprehensive income</b>	Final stages —IFRS and US GAAP amendments to be issued in May 2011. Further consideration is on other aspects of Financial Statement Presentation are not expected before December 2011.	Amendments to IFRSs and US GAAP for presentation of other comprehensive income to be issued in May 2011.
7	<b>Financial instruments with the characteristics of equity</b>	Reassessed as a lower priority project. Further consideration is not expected before December 2011.	Joint discussion paper published in 2008.
8	<b>Intangible assets</b>	The IASB decided not to proceed with the project, but will reconsider it when it sets its new agenda.	The IASB considered an agenda proposal to add a project on intangible assets in December 2007.

## **APPENDIX B—Work plan for remaining priority convergence projects**

### **Revenue recognition**

1. The IASB and FASB published a joint discussion paper in December 2008 that proposed a single revenue recognition model that was built on the principle that an entity should recognise revenue when it satisfies its performance obligations in a contract by transferring control of goods or services to a customer. That principle is similar to many existing requirements. However, the boards think that clarifying that principle and applying it consistently to all contracts with customers will improve the comparability and understandability of revenue for users of financial statements. That principle formed the basis for a joint exposure draft.
2. The project is critical to both the FASB and the IASB. US GAAP has a wide range of very detailed industry-specific requirements. The IASB has very general requirements that cause preparers to rely on US GAAP for specific guidance. The project is intended to reduce the FASB's detailed guidance to consistent principles and to remove the need for IFRS users to refer to US GAAP.
3. The boards have been considering the feedback received from comment letters and the boards' extensive outreach activities and are close to completing their redeliberations. Once the boards have completed those redeliberations, they will consider whether re-exposure of the proposal is needed. If the boards conclude that re-exposure is not necessary at this stage, they intend to develop a draft of the new standard, which will be:
  - (a) made generally available, via the boards' websites, for interested parties to review;
  - (b) used as the basis for outreach with parties that are most affected by the proposed new requirements; and
  - (c) subjected to a detailed drafting review with selected parties, as part of the fatal-flaw review process each board is required to undertake.



4. The boards will consider the feedback that they receive from these steps to assess whether they can proceed to finalise the standard, whether additional work is required or whether re-exposure is necessary at that point.
5. Completing these steps means that the revenue recognition project will not be finalised by 30 June 2011. However, the boards are committed to these processes because the quality of the final standard is paramount.

## **Leasing**

6. The objective of this project is to improve financial reporting by ensuring that all assets and liabilities arising from lease contracts are recognised in the statement of financial position. Lease obligations are widely considered a significant source of off balance sheet financing. The project will provide accounting standards for both lessors and lessees.
7. The boards published a joint exposure draft in August 2010. The proposals would bring lease obligations and the related assets onto the balance sheets (statements of financial position) of lessees. The proposals for lessors were designed to ensure that an entity that retains significant risks or benefits of the leased asset would recognise that asset and an associated obligation to allow the lessee to use the asset. In other cases, when the significant risks or benefits of the leased asset are transferred to the lessee, the lessor would derecognise the portion of the asset that is transferred by the lease agreement.
8. The boards have been considering the feedback received from comment letters and the boards' extensive outreach activities and are close to completing their deliberations. In the light of that feedback, the boards have already made tentative decisions that mean that the standard they are working towards will reflect changes from the exposure draft. Once the boards have completed those redeliberations, the boards will consider whether re-exposure of the proposal is needed. If the boards conclude that re-exposure is not necessary at this stage, they intend to develop a draft of the new standard, which will be:

- (a) made generally available, via the boards' websites, for interested parties to review;
  - (b) used as the basis for outreach with parties in that are most affected by the proposed new requirements; and
  - (c) subjected to a detailed drafting review with selected parties, as part of the fatal-flaw review process each board is required to undertake.
9. The boards will consider the feedback that they receive from these steps to assess whether they can proceed to finalise the standard, whether additional work is required or whether re-exposure is necessary at that point.
10. Completing these steps means that the leasing project will not be finalised by 30 June 2011. However, the boards are committed to these processes because the quality of the final standard is paramount.

## **Insurance contracts**

11. Insurance contracts has been an active project for the IASB since its formation in 2001. It is an important project because IFRSs currently permit a wide variety of accounting for insurance contracts. In 2007 the IASB published a discussion paper, *Preliminary Views on Insurance Contracts*. In August 2007, the FASB issued an Invitation to Comment, *An FASB Proposal: Accounting for Insurance Contracts by Insurers and Policyholders*, which included the IASB's Discussion Paper. In October 2008 the FASB added a project on insurance contracts to its agenda and the boards agreed to undertake it jointly.
12. The IASB published an exposure draft *Insurance Contracts* on 30 July 2010. The FASB published a discussion document of its own, which included alternative views, in September 2010.
13. Most recently, the boards have been considering together the feedback received on the IASB's exposure draft and the FASB discussion paper. The boards are conducting targeted outreach, based on the decisions made, to a broad range of global constituents and will continue to do so on future decisions.

14. The boards are aiming to complete their deliberations on the major issues by the end of June, but are unlikely to have completed all discussions until the second half of 2011. Once the boards have completed their deliberations, they will prepare their next due-process documents. For the FASB this will be an exposure draft and for the IASB this will be an IFRS. Before an insurance contracts standard is finalised the boards will follow the same procedures described for the revenue recognition and leases projects, including assessing whether the proposals should be re-exposed and making a draft widely available as the basis for performing additional outreach.
15. The IASB is working to issue a new IFRS by the end of 2011. The FASB will consider the feedback received on its exposure draft with a view to finalising a standard in 2012. The boards will then consider any differences that may have arisen and how best to address them.

## **Financial instruments**

16. Our efforts to improve our requirements and to reach a common solution have been complicated by differing imperatives that pushed our respective development timetables out of alignment. In particular, responding to requests from G20 Leaders and others, the IASB has been replacing its financial instrument requirements in a phased approach, whereas the FASB developed a single proposal. Those differing development timetables and other factors have impeded the ability of the boards to publish joint proposals on a number of important technical issues. Because the boards did not publish joint proposals, the result has been different approaches being exposed for public comment.
17. Our strategy for addressing those differences remains the same—each board has been publishing its proposals while also soliciting comment on those of the other board, as a way of giving interested parties the opportunity to compare and assess the relative merits of both boards' proposals. We will consider the comment letters and other feedback that we each receive, in an effort to reconcile our differences in ways that foster improvement and convergence.

## ***Classification and measurement***

### *IASB*

18. In November 2009 the IASB finalised new requirements on the classification and measurement of financial assets by issuing IFRS 9 *Financial Instruments*. IFRS 9 has two classification categories—amortised cost and fair value. Although the mandatory application date for IFRS 9 is 1 January 2013, it was made available for earlier application from the date when it was published. Those who wished to use it could therefore do so for their 2009 year-end financial statements. Many jurisdictions have already made IFRS 9 available for use by their registrants, including Australia, Brazil, Hong Kong, Japan (for those applying IFRSs from 2010), New Zealand and South Africa.
19. In publishing the first phase of IFRS 9, the IASB chose to defer consideration of the accounting for financial liabilities, limiting the standard to financial assets. Most respondents to the exposure draft preceding IFRS 9 told the IASB that the accounting for financial liabilities has worked well except for one issue—the volatility in net income that arises when an entity’s own debt is measured at fair value. In such cases, changes in the creditworthiness of the issuer causes net income volatility (the ‘own credit issue’). There is particular concern that as an entity’s credit quality deteriorates, the entity reports accounting gains, which is counter-intuitive. Responding to feedback received, the IASB decided not to undertake a comprehensive overhaul of the accounting for financial liabilities, but instead to make a targeted change to address only the own credit issue.
20. In May 2010 the IASB published an exposure draft proposing a solution to the own credit issue. The IASB finalised and added these requirements to IFRS 9 in November 2010, with an effective date of 1 January 2013 (although earlier application is permitted).

### *FASB*

21. In May 2010 the FASB published an exposure draft addressing the classification and measurement of financial instruments, impairment accounting and hedge accounting. The comment period ended on 30 September 2010 and the FASB held a series of round tables in October. The FASB’s exposure draft proposed a much greater use of fair value measurement than does IFRS 9, with almost all financial instruments recognised on the

balance sheet (in the statement of financial position) at fair value. The proposal included an amortised cost option for some financial liabilities.

22. The FASB plans to continue to further refine the criteria for classifying financial instruments within the categories listed above, as well as refining the application of those criteria to some financial instruments. The feedback received by the FASB generally agreed with the proposal that assets held for trading, assets held for sale, and financial instruments with variable cash flows should be reported at fair value, with changes in value being reported in net income. However, there was general disagreement with the FASB's proposal to recognise loans, receivables and a company's own debt at fair value in the statement of financial position. Those who disagreed recommended amortised cost for those items, with a more robust impairment approach for loans.
23. Many investors stated that fair value disclosure for loans and liabilities is useful information, but that they would prefer that the information be provided in the footnotes (or through other means), rather than as the primary measure in the financial statements.
24. After considering the feedback received, the FASB has tentatively decided to consider three categories for financial assets: (a) fair value measurement with all changes in fair value recognised in net income (trading or holding for sale); (b) fair value measurement with changes in fair value recognised in other comprehensive income (investing with a focus on managing risk exposures or maximising total return); and (c) amortised cost, subject to an improved impairment approach (customer financing with ability to manage credit risk by renegotiating cash flows with customers) and enhanced disclosures.

#### *Convergence*

25. When the FASB has made its decisions about classification and measurement, which it expects to do in the third quarter of 2011, the IASB will expose the FASB's final conclusions to seek views from its own constituents.

## ***Impairment***

26. In November 2009 the IASB published an exposure draft proposing a move to a more forward-looking expected loss impairment/provisions model. During the comment period, an Expert Advisory Panel (EAP) was set up, comprising credit and systems experts. The mandate of the EAP was to provide the boards with feedback on the operational issues associated with introducing an expected loss impairment model. Prudential regulators were active participants in the EAP.
27. The IASB received broad support for a move to an expected loss impairment model. However, a number of operational challenges were identified with the model proposed in the exposure draft, and the EAP provided helpful feedback on those matters. The IASB has been working through the issues identified by comment letter respondents, by the EAP and in the board's extensive outreach programme, conscious that it will be important to ensure that there is sufficient stakeholder input before any new impairment requirements are finalised.
28. The May 2010 exposure draft published by the FASB included impairment in addition to the classification and measurement of financial instruments and hedge accounting. The comment period ended on 30 September 2010 and the FASB held a series of round tables in October. The exposure draft proposed recognising a credit impairment when, having considered past events and existing conditions, an entity does not expect to collect all of an instrument's contractual cash flows.
29. The boards began joint redeliberations on impairment in November 2010. In January 2011, the boards published *Supplementary Document –Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Impairment*. The supplement presented an impairment model that reflected the differing objectives for impairment accounting while proposing a common solution to impairment. The comment period closed on 1 April.
30. The supplement outlined a model in which the amount and timing of recognition would vary according to the credit characteristics of the financial asset, specifically the degree of uncertainty about the collectibility of cash flows.

31. The model distinguished between those financial assets for which the entire amount of expected credit losses would be recognised immediately (the ‘bad book’), and the ‘good book’. For the good book, expected credit losses would be recognised proportionately over the life of the loan, subject to a minimum (or floor) reflecting the credit losses expected to occur within the foreseeable future period (which would be a minimum of twelve months). In determining the expected credit loss estimate, all available information that is reasonable and supportable, including expectations about future events and conditions should be considered.
32. In April the boards considered the feedback from comment letters and the boards’ extensive outreach activities. There was no clear consensus among respondents. The boards are working through the issues and suggestions and are determined to reach a consensus on a basic approach by the end of June. Once the boards have reached consensus they will need to assess what additional steps, such as potential re-exposure or outreach, are necessary to allow the new requirements to be finalised.

### ***Hedge accounting***

33. As part of the MoU, the boards worked jointly on a research project to reduce the complexity of the accounting for financial instruments. This joint effort resulted in the IASB publishing in March 2008 a Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, which the FASB also published for comment. Focusing on the measurement of financial instruments and hedge accounting, the discussion paper identified several possible approaches for improving and simplifying the accounting for financial instruments.
34. In response to requests to address numerous issues on many aspects of its existing hedge accounting, the FASB issued an exposure draft, *Accounting for Hedging Activities*, in June 2008. Many who responded to that exposure draft were concerned that the proposed amendments would create further divergence between the hedge accounting in US GAAP and in IFRSs.
35. In addition to the classification and measurement of financial instruments and impairment, the FASB’s May 2010 exposure draft also included a proposal on hedge accounting.

36. The IASB published an exposure draft on general hedge accounting in December 2010. In February 2011 the FASB published a discussion paper on the IASB's exposure draft to seek comments from its own stakeholders on that proposal.
37. The IASB plans to complete its redeliberations associated with those improvements over the next few months. The FASB will participate in and consider the feedback on, and the IASB's discussion of, the IASB exposure draft, along with feedback on its own exposure draft as it continues redeliberations in the next few months.
38. The IASB exposure draft was concerned with general hedge accounting. It did not address portfolio hedge accounting. The IASB resumed its public discussion of portfolio hedges in April and expects to further develop its proposals related to portfolio hedge accounting before it finalises the more general hedge accounting requirements. The IASB expects to publish an exposure draft for portfolio hedge accounting later this year.

***Balance sheet netting of derivatives and other financial instruments***

39. In response to stakeholders' concerns regarding the comparability of entities using IFRSs and US GAAP, the IASB and FASB expanded the scope of the joint project on financial instruments to address the netting or offsetting of financial assets. This is the single largest source of difference between the balance sheets (statements of financial position) of financial institutions using US GAAP and of those using IFRSs.
40. The boards published joint exposure drafts in the first quarter of 2011 and aim to substantially complete redeliberations in the next quarter. The boards have public round table meetings planned for London, Norwalk and Singapore in May.