

IASB Update

From the International Accounting Standards Board



April 2012

Welcome to IASB Update

The IASB met in public over five days, starting on Monday 16 April 2012. The FASB joined the IASB for some of the sessions both in person and via video from its offices in Norwalk.

The topics for discussion at the joint IASB/FASB meeting were:

- Classification and measurement
- Impairment
- Investment entities
- Insurance contracts

The topics discussed at the IASB meeting were:

- Annual improvements: IAS 38 and IAS 16—revenue-based depreciation method
- IFRS Interpretations Committee update
- Work plan

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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 2012 are:

17-18 May (Education)

21-25 May

11-15 June 2012

16-20 July 2012

To see all Board meetings for 2012, [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) of previous Board meetings, [click here](#).

IASB/FASB sessions

Classification and measurement

The IASB and FASB discussed the business model assessment for amortised cost classification for financial assets and bifurcation of financial assets and financial liabilities.

Business model assessment for amortised cost classification for financial assets

The boards tentatively decided that financial assets would qualify for amortised cost if the objective of the business model is to hold those assets to collect contractual cash flows. The boards tentatively decided to clarify the primary objective of 'hold to collect' by providing additional implementation guidance on both the types of business activities and the frequency and nature of sales that would prohibit financial assets from qualifying for amortised cost measurement.

All IASB members and four FASB members agreed.

Bifurcation of financial assets and financial liabilities

The boards tentatively decided that financial assets with cash flows that are not solely principal and interest would not be eligible for bifurcation. Instead, they would be classified and measured in their entirety at fair value through profit or loss. The boards tentatively decided that financial liabilities would be bifurcated using their existing bifurcation requirements in IFRS 9 and US GAAP. The IASB also confirmed that the 'own credit' requirements in IFRS 9 would be retained. The FASB will discuss 'own credit' presentation requirements at a future FASB-only meeting. Eleven IASB members and five FASB members agreed.

Impairment

Expected credit loss estimates

At this meeting, the IASB and FASB clarified the attributes of an expected credit loss estimate to address concerns raised regarding the use of the term 'expected value'.

The boards clarified that an estimate of expected credit losses shall reflect the following:

- a. all reasonable and supportable information considered relevant in making the forward-looking estimate;
- b. a range of possible outcomes and the likelihood and reasonableness of those outcomes (that is, not merely an estimate of the 'most likely outcome'); and
- c. the time value of money.

The boards clarified that an entity shall consider information that is reasonably available without undue cost and effort in estimating expected credit losses.

Thirteen IASB members and seven FASB members agreed. One IASB member was absent.

Bucket 1 measurement approach

The boards also clarified that the Bucket 1 measurement approach would be defined as 'expected losses for those financial assets on which a loss event is expected in the next twelve months'.

In further explaining the Bucket 1 approach, the boards indicated that:

- a. Expected losses are cash shortfalls expected over the lifetime of the financial asset (ie the full loss content) that are associated with the likelihood of a loss event in the next twelve months. That is, the losses being measured are not only the cash shortfalls over the next 12 months.
- b. Estimating lifetime losses should not require a detailed estimate for periods far in the future, but the degree of detail necessary in forecasting estimated losses decreases as the forecast period increases.
- c. Various approaches can be used to estimate the expected losses, including approaches that do not include an explicit '12 month probability of a loss event' as an input.

Thirteen IASB members and five FASB members agreed. One IASB member was absent.

Trade receivables

In February 2012 and at this meeting, the boards discussed whether an expected credit loss model should be applied to trade receivables that do not have a significant financing component (as defined in the revenue exposure draft).

In the February meeting, subject to deciding whether an expected loss model should be applied to these trade receivables, the boards had tentatively decided how an expected loss approach in general would be applied and requested the staff to evaluate whether an expected loss model would be operational for these trade receivables. The evaluation was the basis for the discussions at this April meeting. On the basis of discussions at both meetings, the boards tentatively agreed that an expected loss model should be applied to trade receivables that do not have a significant financing component, including a practical expedient that a provision matrix can be used.

Twelve IASB members and seven FASB members agreed. One IASB member was absent.

Next steps

At the end of the meeting, the boards asked the staff for an update on the project, including what topics still needed to be addressed jointly. The staff noted that the general framework of the model was now complete as a result of the decisions reached at this meeting. However, the staff will prepare joint papers for discussions related to off balance sheet items, disclosures, transition and any knock on effects resulting from future decisions in the classification and measurement project. Each board may also have separate issues to individually consider in order to address their respective stakeholders' concerns.

Investment entities

The IASB and FASB discussed summaries of the feedback received on the IASB exposure draft *Investment Entities* and the FASB proposed Accounting Standards Update *Financial Services-Investment Companies: Amendments to the Scope, Measurement and Disclosure Requirements*. The meeting was educational in nature and the boards were not asked to make any decisions.

Insurance contracts

The IASB and FASB continued their discussions on insurance contracts by considering reinsurance and

issues related to policy loans and contract modifications (including riders). They also held an education session on the single margin approach tentatively adopted by the FASB.

Reinsurance

The boards tentatively decided that:

- a. For retroactive reinsurance contracts, the residual or single margin included in the cedant's reinsurance recoverable and the reinsurer's insurance contract liability should be amortised over the remaining settlement period in the same manner as the release of the single/residual margin (in line with the pattern of services (for the IASB) or release from risk (for the FASB)).
All IASB and all FASB members present supported this decision. One IASB member was absent.
- b. An insurer should treat cash flows resulting from contractual features affecting the amount of premiums and ceding commissions that are contingent on claims or benefits experience (often referred to as 'loss sensitive features') as part of the claims and benefits cash flows (rather than as part of the premiums) if they are not accounted for as investment components. An insurer should treat any premium adjustments that are not loss-sensitive in the same way as other changes in estimates of premiums arising from the contract. Any features that provide cedants with a unilateral right (but not an obligation) to pay a premium and reinstate a reinsurance contract should not be considered to be loss sensitive features for the purpose of applying this guidance.
All IASB and all FASB members present supported this decision. One IASB member was absent.

Measurement of the contract

The IASB tentatively decided that both the cedant and the reinsurer should evaluate whether to account for the reinsurance contract using the building block approach (BBA) or the premium allocation approach (PAA) in the same manner in which an insurer should evaluate a direct insurance contract. In other words, the PAA would be permitted if it would produce measurements that are a reasonable proxy to those that are produced by the BBA.

All IASB members present supported this decision. One IASB member was absent.

The FASB tentatively decided that:

- a. The **reinsurer** should evaluate whether to account for the reinsurance contract under the building block approach or premium allocation approach in the same manner in which an insurer should evaluate a direct insurance contract. In another words, insurers should apply the BBA rather than the PAA if, at the contract inception date, either of the following conditions is met:
 - i. it is likely that, during the period before a claim is incurred, there will be a significant change in the expectations of the net cash flows required to fulfil the contract; or
 - ii. significant judgement is required to allocate the premium to the insurer's obligation to each reporting period.
 All FASB members supported this decision.
- b. The **cedant** should account for a reinsurance contract using the same approach (building block approach or premium allocation approach) that the cedant uses to account for the underlying direct insurance contracts. Reinsurance contracts that reinsure both insurance contracts measured using the building block approach and insurance contracts measured using the premium allocation approach, should be separated based on the underlying contract measurement model, with each component being accounted for using the same approach used to account for the underlying direct insurance contracts.
Six FASB members supported this decision.

Policy loans and contract modifications (including riders)

The boards tentatively decided that in applying the general decisions on unbundling and disaggregation, policy loans should be considered in determining the amount of the investment component to which they relate.

Twelve IASB and all FASB members present supported this decision. One IASB member was absent.

The boards will consider disclosures about the amount of policy loans taken out at a future meeting.

The boards also tentatively decided that:

- a. An insurer should account for contract modifications (ie. riders) that are part of the insurance contract at inception as part of the contractual terms of the contract. Thus the general decisions on unbundling and disaggregation should apply to riders.
All IASB and all FASB members present supported this decision. One IASB member was absent.
- b. An insurer should derecognise an existing contract and recognise a new contract (under the applicable guidance for the new contract) if it amends the contract in a way that would have resulted in a different assessment of either of the following items had the amended terms been in place at the inception of the contract:
 - i. whether the contract is within the scope of the insurance contract standard; or
 - ii. whether to use the premium allocation approach or the building block approach to account for the insurance contract.
All IASB and FASB members present supported this decision. One IASB member was absent.
- c. In addition, the IASB tentatively decided that an insurer shall derecognise an existing contract and recognise a new contract if it amends the contract in a way that would have resulted in the contract being included in a different portfolio than the one in which it was included in at initial recognition.
All IASB members present supported this decision. One IASB member was absent. The FASB plans to consider which additional circumstances will result in derecognition and whether there needs to be application guidance.
- d. When an insurer makes a substantial modification to an insurance contract, the gain or loss on extinguishment of the original contract should be determined by measuring the existing insurance contract using the current entity-specific price that the insurer would hypothetically charge the policyholder for a contract equivalent to the newly recognised insurance contract.
Twelve IASB and six FASB members present supported this decision. One IASB member was absent.
- e. Insurers should account for non-substantial modifications as follows:
 - i. If the modification eliminates the insurer's obligation to provide some of the benefits that the contract would previously have required, the insurer shall derecognise that portion of its obligation (including any related portion of the residual/single margin).
 - ii. If the modification entitles the policyholder to further benefits, the insurer shall treat the modification as if the amendment was a new standalone contract (ie, the margin is determined in the same way as for a new standalone contract with no effect on the measurement of the original contract)
Twelve IASB and five FASB members present supported this decision. One IASB member was absent.
- f. Reinsurers and cedants shall present any gains or losses on commutations as an adjustment to claims or benefits and shall not gross up the premiums, claims, or benefits in recognising the transaction on the statement of comprehensive income.
All IASB and FASB members present supported this decision. One IASB member was absent. The boards will consider disclosures about commutations at a future meeting.

Single margin

The FASB held an education session for the IASB on the single margin approach. The Board was not asked to make any decisions.

The use of other comprehensive income

The IASB and FASB held an education session on how to use other comprehensive income for presenting the effects arising from changes in specified assumptions on the insurance contract liability. The boards were not asked to make any decisions.

IASB sessions

Annual improvements: IAS 38 and IAS 16—revenue-based depreciation method

The IASB discussed a proposed amendment to paragraph 62 in IAS 16 *Property, Plant and Equipment* and paragraph 98 in IAS 38 *Intangibles* relating to selecting an appropriate depreciation and/or amortisation method.

The amendment would clarify that a method of depreciation or amortisation based on the revenue expected to be generated from using the asset in an entity's business is not appropriate. This is because this method reflects a pattern of generation of economic benefits from operating the business (of which the asset is a part), rather than the consumption of the economic benefits embodied in the asset.

The Board tentatively decided to include the proposed amendment within the Annual Improvements to IFRSs 2011-2013 cycle.

Thirteen Board members supported this decision.

IFRS Interpretations Committee update

The IASB received an update from the March 2012 meeting of the IFRS Interpretations Committee. Details of the meeting were published in IFRIC Update, which is available by [clicking here](#).

Work plan

The work plan reflecting decisions made at this meeting will be updated on the IASB website in the week beginning 23 April 2012. Initiation of the post-implementation review of IFRS 3 is planned for Q3 2012. There are no changes to other planned milestones.

Projected targets as at 23 April 2012	2012 Q2	2012 Q3	2012 Q4	2013 Q1	MoU	Joint
Next major project milestone						
Agenda consultation						
Three-yearly public consultation	Feedback Statement	Development of strategy				
Next major project milestone						
Financial Crisis related projects						
IFRS 9: Financial instruments (replacement of IAS 39)						

- Classification and measurement (review)		Target ED		✓	✓
- Impairment		Re-exposure		✓	✓
Hedge accounting					
- General hedge accounting	Review draft	Target IFRS		✓	
- Macro hedge accounting		Target DP or ED		✓	
Next major project milestone					
Memorandum of Understanding projects					
Leases		Re-exposure		✓	✓
Revenue recognition	Consider comments received			✓	✓
Next major project milestone					
Other Projects					
Insurance contracts		Review draft or revised ED			✓
Annual improvements 2009-2011	Target completion				
Annual improvements 2010-2012	Target ED				
Annual improvements 2011-2013		Target ED			
Consolidation–Investment entities					✓
Transition Guidance (Proposed amendments to IFRS 10)	Target amendment				
Next major project milestone					
Post-implementation reviews					
IFRS 8 Operating Segments	Request for Views				
IFRS 3 Business Combinations		Initiate review			

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