BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

September 2008

IASB Update *is published as a convenience for the Board's constituents. All conclusions reported are tentative and may be changed or modified at future Board meetings.*

Decisions become final only after completion of a formal ballot to issue a Standard or Interpretation or to publish an Exposure Draft.

The International Accounting Standards Board met in London on 15-19 September, when it discussed:

- Credit Crisis
- Annual Improvements
- Extractive activities
- Fair value measurement
- Financial instruments with characteristics of equity
- First-time Adoption of IFRSs
- IFRS for private entities (formerly small and medium-sized entities, or SMEs)
- Insurance contracts
- Related Party Disclosures
- Revenue recognition
- Share-based Payment
- Update on IFRIC activities

Credit Crisis

The Board discussed various aspects of its response to the credit crisis:

- Inactive markets (valuing financial instruments when markets are no longer active)
- Consolidation round-table
- Disclosure: off-balance sheet entities
- Disclosure: liquidity risk
- Disclosure: fair value of financial instruments

Inactive markets

In response to recommendations of the Financial Stability Forum in its report *Enhancing Market and Institutional Resilience*, the Board set up and consulted an expert advisory panel. The panel met six times from June to August 2008 to discuss measurement and disclosure issues encountered. As a result of those discussions, the staff prepared a draft report summarising practices that experts use for measuring and disclosing financial instruments when markets are no longer active.

The draft report provides information and educational guidance for measuring and disclosing fair values and does not propose new requirements for entities applying IFRSs. However, the Board noted that the panel's discussions will be useful for future standards, including the forthcoming fair value measurement standard, and had already provided helpful input for possible amendments to IFRS 7 *Financial Instruments: Disclosures* (see below).

The draft report is on the IASB Website at http://www.iasb.org/expert-advisory-panel. The staff will consider any comments on the draft report received by 3 October 2008. The staff will finalise the report after the next panel meeting in October 2008 and post it on the IASB Website.

Consolidation round-table

To receive views from external parties, the Board held a round-table meeting to discuss a working draft of an exposure draft on consolidation. For more information about the draft and the round-tables, please refer to http://www.iasb.org/Current+Projects/IASB+Projects/Consolidation/Consolidation.htm

Disclosure: off-balance sheet entities

The Board discussed possible disclosure requirements for off-balance sheet entities and tentatively decided to propose disclosure requirements about:

- the application of the consolidation policy and the financial effect of the consolidation decision when significant judgement has been applied
- the nature of an entity's involvement with off-balance sheet entities and associated risks. The Board asked the staff to investigate how such entities should be defined, noting that concerns in this area relate mainly to the use of separate entities to manage securitisations and other structured financing arrangements and investments.

Disclosures about these off-balance sheet entities would depend on whether a financial instrument exposes the reporting entity to risks caused by the off-balance sheet entity. Such instruments could include guarantees and agreements to provide liquidity support.

- If such a financial instrument exists, IFRS 7 applies. The Board discussed possible enhancements to the disclosures either in IFRS 7, or the new consolidation standard, to deal with particular concerns about the risks arising in these circumstances.
- If no such financial instrument exists, IFRS 7 does not apply. The Board considered the possible need for additional disclosures about off-balance sheet entities sponsored by the reporting entity, and about cases in which the reporting entity had supported such entities with no contractual obligation to do so.

Disclosure: liquidity risk

The Board discussed possible changes to the liquidity risk disclosure requirements in IFRS 7 in the light of staff discussions with some interested parties.

- The Board tentatively decided that those requirements should apply to

An **additional Board meeting** is being held on 2 October 2008.

This extra meeting is to discuss potential amendments to IFRS 7 *Financial Instruments: Disclosures* and a revised version of the staff draft of the forthcoming exposure draft of a proposed IFRS on consolidation.

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financial liabilities that are settled in cash or another financial asset. Furthermore, the Board tentatively decided on the following approach for liquidity risk disclosures:

- For derivative financial liabilities, an entity should disclose a quantitative maturity analysis based on how the entity manages the liquidity risk associated with such instruments. Additional disclosures would be required for particular types of derivatives.
- For non-derivative financial liabilities (including hybrid financial liabilities), an entity should disclose a quantitative maturity analysis based on the instruments' earliest contractual maturities. If the entity does not manage liquidity risk for some items based on those contractual maturities, the entity should also disclose a quantitative maturity analysis based on how it manages the liquidity risk for those items.

Disclosure: fair value of financial instruments

The Board discussed the disclosures about the fair value of financial instruments. The Board tentatively decided to amend IFRS 7:

- to require entities to classify and disclose fair value measurements using a fair value hierarchy that is consistent with the hierarchy in IAS 39 *Financial Instruments: Recognition and Measurement*. This existing hierarchy contains the following three levels:
  - (a) Level 1: fair values measured using quoted prices in an active market for identical assets or liabilities
  - (b) Level 2: fair values measured using valuation techniques for which all inputs significant to the measurement are based on observable market data
  - (c) Level 3: fair values measured using valuation techniques for which any input significant to the measurement is not based on observable market data.
- to require entities to present quantitative disclosures about fair value measurements in a tabular format unless another format is more appropriate to the circumstances.
- for fair value measurement using significant unobservable inputs (Level 3), to require a reconciliation from period to period along with a narrative description about any transfers between levels of the hierarchy and the reasons for those transfers.
- for fair values that are disclosed but not recognised, to require an indication of the level of the hierarchy in which the instrument is classified.

The Board noted that paragraph 15 of IAS 34 *Interim Financial Reporting* states that an entity should disclose 'At an interim date, an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period'. The Board tentatively decided not to propose amendments to IAS 34.

Next steps

The Board will hold an additional public meeting on Thursday 2 October to continue its discussion of consolidation and enhanced disclosures about off balance sheet entities, liquidity risk and fair value measurement. The Board plans to publish exposure drafts on these subjects by the end of this year.

To learn more about the Board's response to the credit crisis, please refer to the credit crisis page on the Website http://www.iasb.org/About+Us/About+the+IASB/Response+to+the+credit+crisis.htm

Annual Improvements

IFRIC 13 *Customer Loyalty Programmes* – fair value of award credit

IFRIC 13 uses the term 'fair value' to refer both to the value of the award credits and to the value of the awards for which the credits could be redeemed. The Board noted that this could be mis-interpreted to mean that the fair value of the award credits is the same as the fair value of the awards for which they could be redeemed, without regard to expected forfeitures. To address this, the Board tentatively decided to amend IFRIC 13 to clarify the measurement guidance for the fair value of the award credits. The Board also tentatively decided that the amendments should be applied prospectively. The Board directed the staff to draft amendments to paragraphs AG2 and IE1 of IFRIC 13.

Extractive activities

At the final education session for the extractive activities research project, the Board discussed some general features of a potential disclosure model for minerals and oil & gas extractive activities. The Board also considered issues relevant to the drafting of the research project's discussion paper, which is planned for completion by the end of 2008.

The Board agreed with the general direction of the disclosure proposals. It suggested that the disclosure objective identified by the project team could be refined to refer more specifically to users' information needs relating to extractive activities. In setting some parameters for the types of disclosures being proposed, the Board agreed that the discussion paper should propose that the same types of information be disclosed across the mining and oil & gas industries. This does not mean that the disclosures presented would be identical for both industries.

The Board suggested that users' needs should be the primary driver for identifying the disclosures that should be proposed in the discussion paper. However, the document should also address preparation and presentation considerations associated with those disclosures. The project team's disclosure proposals are not identical to the disclosures proposed by the US Securities and Exchange Commission to modernise its oil & gas definition and disclosure requirements. Board members suggested that the discussion paper should invite comments on the implications of this.

The Board indicated support for the discussion paper to propose the disclosure of:

- proved and probable reserve volumes. The disclosure of those volumes should be disaggregated by commodity type and by significant risk attributes and the reserve volumes attributable to subsidiaries and investments should be presented on the same basis as applies to the accounting for equity interests in other entities in consolidated financial statements;
- key assumptions associated with the estimate of reserve volumes and a sensitivity analysis of the effect of changes in those assumptions. The discussion focused on commodity

price assumptions and the Board indicated that the use of market participant assumptions is preferred. The fair value hierarchy establishes a process for selecting the most relevant input by referring to Level 1, Level 2 and Level 3 inputs. This may help to identify the pricing assumption that should be used.

- an explanation of changes in the reserve volumes estimates from year to year. This could be a narrative explanation or a quantitative reconciliation, depending on the granularity of the reserve volume disclosures.
- a current value measurement, such as a standardised measure of discounted cash flows, and the key assumptions necessary for a user to make use of that measurement. This would not be disclosed if the minerals or oil & gas assets are measured on the balance sheet at fair value or some other current value measurement. In that case, an entity would provide disclosures similar to those required in the US by paragraph 32 of SFAS 157 *Fair Value Measurements*.
- exploration, development and operating cash outflows, which could be disclosed as a time series over the defined period, such as five years.

The Board received a report on the outcomes from a round-table discussion of the disclosure proposals of the Publish What You Pay coalition. Four Board members and the project team participated in this discussion with representatives from the coalition, investors, mining and oil & gas companies, auditors, and the International Public Sector Accounting Standards Board. The discussion paper will discuss those proposals.

The Board noted that the research project's discussion paper will be published as an IASB document but contain only the project team's views. The discussion paper will be the initial due process document for the Board's deliberations on extractive activities, if the Board subsequently adds this project to its active agenda.

Fair Value Measurement

The Board continued its discussion of fair value measurement, focusing on highest and best use and blockage factors.

Highest and best use

The Board discussed whether a fair value measurement should reflect the highest and best use of an asset. The Board tentatively decided the following:

- The fair value of an asset should reflect its highest and best use. The highest and best use is the use by market participants that would maximise the value of the asset or of the group of assets in which the asset would be used. It considers uses of the asset that are physically possible, legally permissible and financially feasible at the measurement date. The Board tentatively decided to include in an exposure draft on fair value measurement a description of each criterion and an explanation of how they apply in a fair value measurement.
- The exposure draft should state explicitly that an entity does not need to perform an exhaustive search to find other potential uses on which to base the valuation if there is no evidence to suggest that the current use of the asset is not its highest and best use.
- When an entity measures an asset at fair value and currently uses the asset together with another asset in a use that differs from their highest and best use, the entity may need to split the fair value into two components: (a) the fair value of the asset assuming its current use and (b) a 'change of use option' reflecting the entity's ability to switch the asset to its highest and best use.

Blockage factors

The Board discussed whether a fair value measurement should include an adjustment for the size of an entity's holding relative to trading volume (a blockage factor). The Board confirmed its preliminary view, expressed in the discussion papers on *Fair Value Measurements* and *Reducing Complexity in Reporting Financial Instruments,* that the measurement objective should be to measure fair value at the individual instrument level. The Board tentatively decided:

- to exclude blockage factors from a fair value measurement at all levels of the fair value hierarchy.
- that a fair value measurement should exclude other discounts or premia (such as a control premium) that apply to a holding of financial instruments and do not apply to the individual instrument.

Next steps

The Board will discuss further topics at its meeting in October.

Financial instruments with characteristics of equity

Representatives from the European Association of Co-operative Banks led an education session to discuss the financial instruments issued by European co-operatives. They discussed the characteristics of those instruments, the current accounting for them and how entities might account for them under the approaches described in the FASB Preliminary Views document *Financial Instruments with Characteristics of Equity*.

No decisions were made.

First-time Adoption of IFRSs

The Board considered matters arising from its review of a draft of an exposure draft proposing amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and tentatively decided to take the following steps:

- Amend the proposed accounting for decommissioning, restoration and similar liabilities when an entity uses the proposed exemption for oil and gas assets for which the entity had used full cost accounting under previous GAAP. Instead of applying paragraph 25E of IFRS 1 or IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, an entity should, at the date of transition to IFRSs:
  - (a) measure those liabilities in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
  - (b) recognise directly in retained earnings any difference at that date between the amount in (a) and the carrying amount of these liabilities determined under the entity's previous GAAP.
- Limit the scope of the proposed exemption for a first-time adopter that has made the same determination under previous GAAP as that required by IFRSs but at a different

date. The exemption would apply only for IFRIC 4 *Determining whether an Arrangement contains a Lease*.

- Remove a proposed prohibition on using fair values as at a date before the date of transition to IFRSs if the information needed to determine them was not available at the date in question.

On 25 September 2008 the Board published an exposure draft *Additional Exemptions for First-time Adopters* containing these and earlier decisions.

IFRS for private entities (formerly small and medium-sized entities, or SMEs)

The Board resumed its redeliberation of the proposals in the exposure draft (ED) of a proposed *IFRS for SMEs*. At this meeting the Board discussed issues relating to Sections 28–38 of the ED and made the following tentative decisions:

Income taxes. The Board considered but rejected a taxes payable with disclosure approach for deferred tax. The Board then discussed possible ways to simplify deferred tax recognition and measurement that take into account the needs of users of private entity financial statements and cost-benefit considerations. The Board asked the staff to develop the following two approaches for discussion at a future meeting:

- Recognising deferred taxes only for those differences between accounting and tax treatment of items of income or expense that are expected to reverse (and therefore affect an entity's cash flows) in a relatively short term.
- Starting from the temporary difference approach in IAS 12, but making simplifications in areas considered particularly complex.

The Board expects to publish an exposure draft on income taxes later in 2008. One aim of that exposure draft is to enhance understandability by substantially rewriting IAS 12, without changing greatly the overall approach in IAS 12. The staff will take this redrafting into account when rewriting Section 28.

Hyperinflationary economies. All characteristics that indicate hyperinflation as listed in paragraph 3 of IAS 29 *Financial Reporting in Hyperinflationary Economies* should be added to the final IFRS for Private Entities.

Foreign currency translation. Private entities should be prohibited from recycling through profit or loss any cumulative exchange differences that were previously recognised in equity on disposal of a foreign operation. Private entities should not be allowed simply to elect to deem their local currency as their functional currency even if the law requires financial statements to be presented in the local currency.

Related parties. The final standard should reflect the final amendments to IAS 24 *Related Party Disclosures*, currently in exposure draft phase.

Agriculture. The cost model should not be added as an accounting policy choice for private entities since the addition of an 'undue cost or effort' exception to the requirement to apply fair value measurement, as proposed in the ED, is considered a sufficient simplification.

Held for sale. There should be no 'held for sale' classification for non-financial assets, or groups of assets and liabilities, as is required by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, and the proposed requirements for assets held for sale in Section 36 should be dropped from the final standard. Instead, the decision to sell an asset should be added as an impairment indicator.

Discontinued operations. Private entities should be required to identify and segregate amounts for discontinued operations in the statement of comprehensive income for the current period and all prior periods presented in the financial statements, unless impracticable. To reflect the Board's decision directly above, the definition of a discontinued operation will no longer refer to components of an entity that are classified as held for sale.

First-time adoption. All of the optional exemptions for first time adopters in IFRS 1 *First-time Adoption of International Financial Reporting Standards* (eg parent and subsidiary adopt at different times, and deemed cost for investment property and intangible assets) should be added to Section 38 so they are available to private entities adopting the IFRS for Private Entities for the first time. An entity should not be allowed to benefit more than once from the special measurement and restatement exemptions available under Section 38, for example if the entity stops using the IFRS for Private Entities for a time and then is required, or chooses, to adopt it again later.

Disclosures. The Board considered a report on the views and recommendations of members of the Private Entities Working Group on disclosure issues, as well as staff recommendations on each. Nearly all of those recommendations were for further disclosure simplifications, although in a few cases the staff recommended additional disclosures. The staff's recommendations were generally consistent with the recommendations of the Working Group and are set out in the attachment to Agenda Paper 6B for the meeting, available on the IASB's Website. The Board agreed with most, but not all, of the staff recommendations. The Board's decisions on disclosures are too numerous and too detailed to be reported individually in *Update*.

Outstanding issues. The Board will discuss outstanding issues in October and November. Some of the main outstanding issues relate to restructuring the financial instruments section, concepts and pervasive principles, classification of equity and debt, measurement of equity-settled share-based payments, accounting for defined benefit plans, impairment of goodwill, and lessee recognition of rent expense under an operating lease. In addition, at the meeting in September 2008 some Board members suggested that the Board should revisit, at a future meeting, several of the tentative decisions made during redeliberations, including the name of the standard, consolidation, amortisation of indefinite-life intangibles, and recognition of actuarial gains and losses.

Insurance contracts

The discussion paper (DP) *Preliminary Views on Insurance Contracts* proposed three building blocks for use in measuring insurance liabilities. The DP suggested that an informative and concise name for the resulting measurement is 'current exit value'.

Several respondents to the DP advocated a measurement that reflects the fact that the insurer intends (and in most cases must) settle the liability by paying the contractual benefits as they become due, rather than by transferring the liability to a third party. The Board discussed:

- why various respondents prefer this notion to current exit value (the measurement attribute proposed by the DP).
- similarities and differences between this notion and current exit value.
- whether this notion corresponds to something that could be described as an attribute of the liability.

The session was educational and no decisions were made.

Next steps

In October the Board will review a list of measurement approaches that the staff view as viable candidates for selection in the case of insurance liabilities. The session will be educational.

Related Party Disclosures

The Board continued its discussion of responses to the exposure draft *State-controlled Entities and the Definition of a Related Party*, published in February 2007.

Exemption for state-controlled entities

The Board tentatively decided to propose a different exemption for state-controlled entities, rather than finalising the exemption proposed in the exposure draft.

The proposal would exempt an entity from disclosing:

- transactions with a state if that state is a related party only because it has control, significant influence or joint control over the entity; and
- transactions with another entity that is a related party only because the same state has control, significant influence or joint control over both entities. For example, the exemption would apply when a state controls both an entity and its parent (unless the entity and its parent also meet the definition of a related party for reasons other than control by the same state).

The proposal would also require the entity to disclose the name of the state that controls, significantly influences or jointly controls it, and the fact that it has transactions with that state or with other entities controlled, significantly influenced or jointly controlled by that state. The staff will consider how to draft a requirement for the entity to indicate the scale of these transactions, without requiring the gathering of extensive information.

Definition of a related party

As a follow up to discussions in November 2007, the Board discussed issues arising from the definition of a related party and tentatively decided:

- that two entities are related if a person or a third entity has joint control over one entity and that person, a close member of that person's family or the third entity jointly controls or significantly influences, or has significant voting power in, the other entity.
- that two entities are not related parties simply because a member of key management personnel of one entity has significant influence over the other entity (to amend paragraphs 9(b)(vi)-(vii) of the exposure draft and paragraph 11(a) of IAS 24).
- that an entity is a related party of the reporting entity if a person controls, significantly influences or jointly controls the reporting entity and a close member of that person's family is a member of the key management personnel of the other entity (to amend paragraph 9(b)(vii) of the exposure draft).
- that a multi-employer plan is a related party of its sponsoring entities and, for the financial statements of the plan, its sponsoring entities are related parties of the plan.
- not to consider in this project whether an entity can be a member of key management personnel.

Interactions with other IFRSs

The Board discussed a consequential amendment to paragraph 34 of IFRS 8 *Operating Segments*. That paragraph requires an entity to disclose information about its reliance on major customers. In November 2007 the Board had tentatively decided that entities would not be regarded as a single customer simply because they are controlled by the same state. At this meeting, the Board tentatively decided that an entity should use judgement to determine whether it should regard entities controlled by the same state as a single customer. The staff will develop guidance on the factors relevant for this judgement, including the extent of economic integration between those state-controlled entities.

The Board noted that the definition of a qualifying insurance policy in IAS 19 *Employee Benefits* refers to the definition of a related party. The Board tentatively decided to attach a footnote to paragraph 68L of the Basis for Conclusions on IAS 19, to draw attention to the revised definition of a related party.

Next step

The Board decided that the proposed exemption for state-controlled entities requires re-exposure. The re-exposure draft will seek input on that proposal and on one aspect of the proposed definition of a related party (described in the first bullet of this subsection). To provide context for respondents, the re-exposure draft will also include the revised definition of a related party. The Board expects to publish the re-exposure draft around the end of this year.

Revenue recognition

At its meeting in May, the Board expressed a preliminary view in favour of measuring performance obligations at the inception of a contract by allocating part of the transaction price (the customer consideration amount) to each obligation.

At this meeting, the Board considered when performance obligations should be remeasured after the contract's inception to reflect changes in prices and circumstances (ie changes other than in the entity's performance).

Remeasure when deemed onerous

The Board tentatively decided that in most cases it would not be necessary to remeasure a performance obligation at each financial statement date. Instead, a performance obligation would be remeasured by exception when deemed onerous.

The Board considered two main approaches for an onerous test. It tentatively decided that a performance obligation is deemed onerous when the entity's expected cost of performance exceeds the carrying amount of the performance obligation. The performance obligation is then remeasured to the entity's expected cost of performance. In the other approach, the performance obligation is deemed onerous when its measurement in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* exceeds the carrying amount of the performance obligation. The performance obligation is then remeasured to the amount in accordance with IAS 37.

Remeasure at each financial statement date

The Board noted that in some cases remeasuring a performance obligation only when deemed onerous might not provide decision-useful information about that obligation after the contract's inception (ie information about the current expected outflow of resources required to satisfy the obligation). The Board tentatively decided that another measurement approach might be required in such cases. In that approach, performance obligations would be remeasured at each financial statement date.

The Board did not discuss when such an approach would be required, but noted that it might be appropriate for performance obligatons in which:

- uncertainty is a significant inherent characteristic of the contract (eg insurance and similar type contracts in which the eventual outcome depends on specified uncertain future events)
- prices of the underlying goods and services are volatile (eg some contracts to supply commodities)
- the contract is of such duration that changes in circumstances are highly likely (eg some construction contracts).

The Board also did not discuss how the performance obligation would be remeasured at each financial statement date. However, it noted that, to be consistent with the initial measurement, the subsequent measurement would have to replicate and update either elements implicit in the transaction price or at least some of those elements (eg the expected cash flows).

The Board tentatively decided that the discussion paper should seek input about the types of performance obligations that might need to be remeasured at each financial statement date even if they are not deemed onerous. The discussion paper will also consider some of the possible approaches for subsequently measuring such obligations, but will not express a preliminary view.

Next steps

The Board will not discuss other issues before the staff submit a draft discussion paper. The discussion paper is expected to be published later this year.

Share-based Payment

The Board discussed issues relating to IFRS 2 that have arisen since its implementation and whether to add a project to the agenda. The Board decided:

- not to address requests involving reconsideration of the principles underlying IFRS 2 in the absence of new information.
- to address some of the application issues in the annual improvements project or other projects.
- to consider addressing differences between IFRS 2 and US GAAP only after progress has been made on related projects (notably the projects on tax and on financial instruments with characteristics of equity).

Accordingly, the Board decided not to add a project on IFRS 2 to its agenda.

In addition, the Board deferred a planned discussion of the project on group cash-settled share-based payment transactions (amendments to IFRS 2 and IFRIC 11)

Update on IFRIC activities

The staff reported on the IFRIC's meeting on 4 and 5 September (see IFRIC Update available here http://www.iasb.org/Updates/Updates.htm). The Board had no questions on the summary provided.

Future Board meetings

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

2008

2 October

13—17 October

20—22 October Norwalk, Connecticut, USA
JOINT MEETING WITH THE FASB

17—21 November

15—19 December

