IASB
BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

UPDATE

February 2009

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 17-20 February, when it discussed:

- Global financial crisis
- IFRS for non-publicly accountable entities
- Interim financial reporting
- Insurance contracts
- Post-employment benefits
- Rate-regulated activities
- Annual improvements

Global financial crisis

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

- Derecognition
- Fair value measurement
- Financial instruments: embedded derivatives

Derecognition

The Board continued its discussion of two approaches to derecognition of financial assets and made the following tentative decisions:

Approach 1

- Scope. The Board tentatively decided to define 'transfers' broadly so that the decision to assess an item for derecognition would not be based on the form of the transaction. A transfer occurs 'when one party passes to or undertakes to pass to another party some or all of the cash flows or other economic benefits underlying its financial assets'. The term 'transfer' is used broadly to include all forms of sale, assignment, and provision of collateral, sacrifice, distribution and other exchange.

Approach 2

- *Scope.* The definition of a transfer is the same as in Approach 1.
- *Determination of the transferor entity.* The determination of the asset being assessed for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity.
- *Definition of the asset to be assessed for derecognition:*
  (a) The determination of the asset to be assessed for derecognition should be on the basis of the remaining interest in the financial asset that was the subject of the transfer.
  (b) A proportionate part of an equity instrument qualifies as an asset to be assessed for derecognition (this is a change from the decision the Board made at the January 2009 meeting).
- *The 'practical ability to transfer' test.* The 'practical ability to transfer' test should be applied to the entity with which the transferor has agreements that result in the transferor's continuing involvement with the transferred asset.
- *Retained interests and beneficial interests.* The Board reaffirmed that a transferor should treat any remaining proportionate interest in the financial asset recognised before the transfer as part of that asset (ie not as a new asset). The Board tentatively decided that a transferor should treat an investment in a transferee vehicle (ie a proportionate beneficial interest) acquired in connection with a transfer as part of the asset previously recognised. If the vehicle contains assets or liabilities in addition to the assets transferred by the transferor, the transferor's investment should be split between (a) a proportionate interest in the previously recognised assets (ie part of the 'old' assets) and (b) a proportionate interest in new assets or liabilities. (This decision is a change from the tentative decision the Board made at its meeting in January 2009).

The Board tentatively decided to propose Approach 2 in the exposure draft, but to include a detailed description of Approach 1 as an alternative view.

The Board tentatively decided that the disclosure objectives for Approach 2 should be to provide information about the:

- nature of, and risks associated with, an entity's continuing involvement with derecognised assets (disclosure objective 1)
- relationship between assets and associated liabilities when an asset is not derecognised following a transaction (disclosure objective 2).

The Board tentatively decided on the following transitional requirements:

- The standard would be applied prospectively to new transactions occurring after its effective date. An entity should not restate information for comparative periods. Earlier application would be permitted.
- For financial assets that were already derecognised but would not have been derecognised under the proposed requirements: an entity would apply disclosure objective (1).
- For financial assets that are still recognised but would have been derecognised under the proposed requirements: an entity would apply disclosure objective (2).

The Board intends to publish the exposure draft in March or April 2009, with a comment period of 120 days.

Fair value measurement

The Board discussed:

- fair value of liabilities
- day one gains or losses
- financial liabilities with a demand feature

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Fair value of liabilities

The Board discussed how to measure the fair value of a liability when there is no observable market price for the liability. The Board tentatively decided that the fair value of a liability equals the fair value of the counterparty's asset in all cases.

Some have suggested that the fair value of the liability might differ from the fair value of the counterparty's asset in some cases, for example if the counterparty's asset is accompanied by a third party credit enhancement. The Board concluded that any apparent differences between the fair values of the liability and the counterparty's asset arise from a failure to define the counterparty's asset in the same way as the liability.

Day one gains or losses

The Board discussed gains and losses arising on initial recognition of financial instruments (day one gains or losses). The Board reaffirmed its tentative decision that the transaction price is the best evidence of fair value at initial recognition except in the cases of related parties, duress, different units of account or different markets. If the transaction price does not represent fair value of a financial instrument at initial recognition, an entity would recognise the resulting day one gain or loss when required by the existing criteria in IAS 39 *Financial Instruments: Recognition and Measurement*. Any deferred gain or loss is a separate item, not part of the fair value.

The Board tentatively decided in January that day one gains or losses should not be recognised for financial instruments measured on a basis other than fair value through profit or loss. To avoid changes to IAS 39 that are beyond the scope of this project, the Board withdrew that decision.

Financial liabilities with a demand feature

The Board tentatively decided to exclude paragraph 49 of IAS 39 from the scope of the exposure draft on fair value measurement. That paragraph describes the measurement objective for a financial liability with a demand feature.

Next steps

The Board has completed its discussions, subject to any matters that arise in drafting. The Board expects to publish an exposure draft towards the beginning of the second quarter of 2009.

Financial instruments: embedded derivatives

In December 2008 the Board published the exposure draft *Embedded Derivatives* (ED) proposing amendments to IAS 39 and to IFRIC 9 *Reassessment of Embedded Derivatives.*

At this meeting the Board discussed the responses to the ED and tentatively decided:

- as proposed in the ED, to require an entity to assess whether an embedded derivative is required to be separated from a host contract when the entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category.
- that the assessment shall be made on the basis of the circumstances that existed when the entity first became a party to the contract or, if later, the date of a change in contractual terms (with a significant effect on cash flows). If an entity cannot make the assessment, the entire hybrid (combined) financial asset remains in fair value through profit or loss.
- as proposed in the ED, that if an entity is unable to measure separately an embedded derivative that would have to be separated, the entire hybrid (combined) financial instrument must remain in the fair value through profit or loss category.
- to require entities to apply the final amendments for annual periods ending on or after 30 June 2009.

The Board directed the staff to draft the final amendments for written ballot.

The staff also provided an update to the Board on the accounting for synthetic collateralised debt obligations (CDOs) and credit derivatives that are embedded in such instruments. The financial crisis section of the IASB website includes more information on this topic.

IFRS for non-publicly accountable entities

The Board discussed the only remaining issue in its project to develop an IFRS for non-publicly accountable entities (formerly private entities or small and medium-sized entities): simplification of defined benefit pension accounting. In the exposure draft of a proposed *IFRS for SMEs* the requirements proposed for defined benefit plans were similar to, but condensed from, those in IAS 19 *Employee Benefits*.

At its meetings in July and November 2008 the Board considered, but did not support, staff proposals to measure the pension obligation at a current termination amount. The Board asked the staff to bring to a future meeting an approach that is more in line with the current IAS 19 approach, but with simplified calculations that would reduce the need for non-publicly accountable entities (NPAEs) to engage external specialists. At this meeting the staff presented a revised approach, based on input from the IASB's Employee Benefits Working Group.

The Board made the following tentative decisions:

- If information based on IAS 19 (projected unit credit etc.) is already available or can be obtained without undue cost or effort, an NPAE should use that method.
- If information based on IAS 19 is not available and cannot be obtained without undue cost or effort, an NPAE would apply an approach that is based on IAS 19 but does not consider future salary progression, future service, or possible mortality during an employee's period of service. This approach would still take into account life expectancy of employees after retirement age. The resulting defined benefit pension obligation would reflect both vested and unvested benefits.
- Comprehensive valuations would not normally be necessary more than once every three years. In the interim periods, the valuations would be rolled forward for aggregate adjustments for employee composition and salaries, but without changing the turnover or mortality assumptions.
- Further guidance would be added on insured benefits.

The Board has now made tentative decisions on all substantive issues. At its meeting in March, the Board will consider whether there is a need for re-exposure before a Standard is issued.

Interim financial reporting

The Board discussed whether some additional disclosure requirements should be mandated in interim financial reports, particularly in current market conditions. The Board tentatively decided to emphasise the disclosure principles in IAS 34 *Interim Financial Reporting* and to consider adding further guidance to illustrate how to apply these principles.

Insurance contracts

The Board discussed the following key aspects of the measurement approaches identified by the staff as viable candidates for insurance contracts:

- features of a measurement approach
- measurement objective
- measurement of the margin at inception

The Board also discussed whether to add to a list of measurement candidates presented by the staff.

Features of a measurement approach

The Board tentatively decided that a measurement approach for insurance contracts conceptually should:

- use estimates of financial market variables that are as consistent as possible with observable market prices
- use explicit current estimates of the expected cash flows
- reflect the time value of money
- include an explicit margin

Measurement objective

The Board discussed whether a measurement approach for insurance contracts should be based on an exit notion or a fulfilment notion. Views diverged and no clear consensus emerged.

Measurement of the margin at inception

The Board tentatively decided that the margin at inception should be measured by reference to the premium and that therefore no day one gains should be recognised in profit or loss.

The Board will discuss at a future meeting how to treat acquisition costs and the part of the premium that recovers those costs.

Candidate measurement approaches

The Board discussed whether to add to the list of measurement candidates presented by the staff and asked the staff to analyse further whether to apply measurement approaches used in other existing and future standards, notably those on revenue recognition, financial instruments and non-financial liabilities.

The Board noted the arguments for and against an approach that uses an estimate of future cash flows with no margins and no discounting. The Board considered whether to use such an approach for non-life claims liabilities and tentatively decided not to add it to the list of candidates. The candidates to be considered at a future meeting include an unearned premium approach for short-duration pre-claims liabilities.

Next steps

In March, the Board will start discussing policyholder behaviour and policyholder participation.

Post-employment benefits

The Board considered how to split the changes in the defined benefit obligation and in plan assets into a remeasurement component and other changes. The Board tentatively decided that the remeasurement component should:

- exclude service cost and interest cost
- include the total return on plan assets and actuarial gains and losses on the defined benefit obligation.

The Board did not decide how entities should present these components in the income statement, nor whether it should require entities to present the remeasurement component as a single line item. The Board will continue its discussion in March.

Rate-regulated activities

The Board tentatively decided that two criteria should define the rate-regulated activities in the scope of this project:

- an authorised body is empowered to establish rates that bind customers; and
- the rate regulation takes the form of a cost-of-service regulation. In such regulation, the rates are designed to recover the specific entity’s costs of providing the goods and services that are subject to regulation and to earn a specified return. The specified return could be a minimum or range and need not be a fixed or guaranteed return.

The Board generally agreed with the analysis supporting the staff’s conclusion that cost-of-service regulation gives rise to items that meet the definition of an asset or a liability in the *Framework*. However, the Board asked the staff to provide further analysis to clarify the nature of the asset, whether financial or intangible, and if intangible, whether and how this asset is distinguishable from the entity’s operating licence. The staff will present recommendations on recognition, measurement and disclosure at a future meeting.

Annual improvements

Annual improvements – 2008

The Board redeliberated two issues from the exposure draft of proposed *Improvements to IFRSs*, published in August 2008:

- Disclosure of information about segment assets (IFRS 8) – The Board tentatively decided to amend paragraph 23 of IFRS 8 *Operating Segments* to clarify that an entity should report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker
- Cash flow hedge accounting (IAS 39) – The Board tentatively decided to amend paragraphs 97 and 100 of IAS 39 *Financial Instruments: Recognition and Measurement* to clarify that, for cash flow hedges, gains and losses on hedging instruments should be reclassified from equity to profit or loss as a reclassification adjustment in the same period or periods that the hedged forecast cash flows affect profit or loss.

The Board also reconsidered the transition requirements for a third issue - classification of land leases (IAS 17). It tentatively decided that when adopting this amendment, an entity would retrospectively:

- reassess whether unexpired land leases are operating or finance leases on the basis of conditions at the inception of the leases; and
- recognise land leases that are now finance leases on the basis of the fair values at the inception of the leases.

The Board also decided tentatively not to require retrospective application when information at the inception of the leases is not available. In such cases, an entity would reassess the classification of unexpired land leases and recognise those newly classified as finance leases on the basis of conditions at, and fair values determined as of, the adoption date.

All three issues will be included in the *Improvements to IFRSs* to be issued in April 2009.

Annual improvements – 2009

The Board tentatively decided to include an issue in the next exposure draft, which it expects to publish in August 2009. The issue deals with how the reconciliation of each item of accumulated other comprehensive income should be presented in the statement of changes in equity. The Board proposes to amend paragraph 106 of IAS 1 *Presentation of Financial Statements* to clarify its original intention that the required amounts may be either presented in the statement of changes in equity or disclosed in the notes.

Future Board meetings

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

2009

16-20 March

23-24 March (IASB and FASB joint meeting)

20-24 April

18-22 May

15-19 June

20-24 July (23-24 July with FASB)

14-18 September

19-23 October

26-27 October (IASB and FASB joint meeting)

16-20 November

14-18 December