BOARD DECISIONS ON INTERNATIONAL FINANCIAL REPORTING STANDARDS

IASB UPDATE

March 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 16-20 March, when it discussed:

- Global financial crisis
- Conceptual framework
- Emissions trading schemes
- Financial instruments with characteristics of equity
- IFRIC
- IFRS for non-publicly accountable entities
- Insurance contracts
- Post-employment benefits
- Revenue recognition
- Annual improvements
- Updates

The IASB also held a joint meeting with the US Financial Accounting Standards Board (FASB) on 23 and 24 March, when the boards discussed:

- Conceptual framework
- Consolidation/derecognition
- Fair value measurement
- Financial instruments – recognition and measurement
- Financial statement presentation
- Loan losses
- Work plan

Global financial crisis

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

- Recent FASB proposals
- Fair value measurement
- Financial instruments – recognition and measurement

Recent FASB proposals

In October 2008 the IASB and the US Financial Accounting Standards Board (FASB) committed themselves to a joint approach in dealing with reporting issues arising from the global financial crisis. On 17 March 2009 the FASB published two draft staff positions (FSPs) that propose additional application guidance on fair value measurement and to amend the impairment requirements for some investments in debt and equity securities to address long-standing US GAAP application issues.

At this meeting the FASB staff provided a summary of the proposed guidance. In the light of its commitment to work jointly with the FASB to address issues arising from the financial crisis, the Board posted a *Request for Views* on the IASB website. The Board seeks comments by 20 April 2009 and will consider those comments before deciding whether to publish formal proposals for public comment. The Board also decided to refer the proposed FSP on guidance on fair value measurement to the IASB Expert Advisory Panel on the fair value measurement and disclosure of financial instruments in markets that are no longer active.

Fair value measurement

On 17 March the FASB issued a Proposed FASB Staff Position (FSP) FAS 157-*e Determining Whether a Market is Not Active and a Transaction is Not Distressed*. The Board noted the publication and decided:

- not to discuss the merits of the approach in the proposed FSP before publishing the exposure draft (ED) on fair value measurements.
- that the invitation to comment on the ED should ask respondents to comment on both the approach in the exposure draft and the approach in the FSP.

The staff provided an update on plans for a round-table meeting to be held after the deadline for comment on the ED. The Board expects to publish the ED towards the end of April.

Financial instruments – recognition and measurement

In November 2008 the Board added to its active agenda a project on the recognition and measurement of financial instruments. At this meeting the Board discussed:

- the objectives of the project.
- criteria that might be considered when determining a measurement attribute for a financial instrument.

No decisions were made. The IASB and the FASB discussed this topic further at their meeting on 23 March.

Conceptual framework

The Board discussed phases A, C and D of the project on the conceptual framework.

Phase A *Objective of Financial Reporting*

The Board reviewed responses to the exposure draft (ED) *An improved Conceptual Framework for Financial Reporting: Chapter 1: Objective of Financial Reporting* and tentatively reaffirmed the proposals in that chapter, including the proposals on the objective of financial reporting and the primary user group. The Board decided tentatively to amend the proposals in the ED as follows:

- to clarify that financial reports do not necessarily exclude forward-looking or prospective information. The description of an economic phenomenon should be amended to reflect this decision.
- to avoid using, when possible, the terms *entity perspective, entity theory* and *proprietary perspective* because they do not convey the boards' views.

The Board directed the staff to start drafting the final versions of the chapters on the objective of financial reporting and the qualitative characteristics of and constraints on financial reporting.

Tel: +44 (0)20 7332 2730
Fax: +44 (0)20 7332 2749
Website: www.iasb.org
Email: publications@iasb.org
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Phase C *Measurement*

The Board continued its discussion of factors that might be used to distinguish between items reported in the financial statements at current amounts and those reported at non-current amounts. The discussion focused on the factor of value realisation, which relates to the qualitative characteristic of relevance. No decisions were taken. The staff will continue to develop the approach to the use of value realisation as well as other factors relating to the qualitative characteristics.

Phase D *Reporting Entity*

The Board decided tentatively that

- the concept of control of an entity should be discussed at a high level in the conceptual framework
- the relationship referred to as 'significant influence' does not constitute control of an entity
- the forthcoming exposure draft should not discuss proportionate consolidation

The Board instructed the staff to start drafting the exposure draft, cautioning that revisions may be needed when the Board discusses comments on ED 10 Consolidated *Financial Statements*, for which the comment period ended on 20 March

Emissions trading schemes

The Board discussed the initial accounting for emission allowances that entities receive free of charge from government in cap and trade emission trading schemes.

Emission allowance

The Board decided tentatively that an entity should recognise emission allowances received free of charge from government as assets. The allowances should initially be measured at fair value.

Corresponding obligation

The Board decided tentatively that if an entity receives allowances free of charge from the government, the entity incurs an obligation to reduce its emissions below the level represented by those allowances (ie its cap). Only if the entity fulfils this obligation will it be entitled to retain some of the allowances. The Board decided tentatively that the entity should recognise a liability for this obligation. The liability is measured initially at the fair value of the allowances received.

Next steps

At future meetings, the Board will consider the subsequent accounting for the emission allowances, the liability that is recognised on receiving allowances and the liability that arises when an entity produces emissions.

Financial instruments with characteristics of equity

The Board published the discussion paper *Financial Instruments with Characteristics of Equity* in February 2008. In October the Board decided to begin deliberations using the principles underlying the perpetual and basic ownership approaches. At this meeting, the Board continued to discuss an approach for determining whether a financial instrument should be classified as equity.

The Board decided tentatively that the following instruments should be classified as equity:

- An ownership instrument that is redeemable at the option of the issuer
- An ownership instrument that is puttable or mandatorily redeemable only upon the holder's retirement or death. (The term *retirement* is used broadly to include events such as termination, resignation or ceasing to be a member in a co-operative or partnership.)

The Board decided tentatively that an ownership instrument that is mandatorily redeemable on a specific date, a range of dates or an event that is certain to occur (other than retirement or death) should be classified as a liability.

The Board directed the staff to analyse further whether the following instruments should be separated into equity and liability components:

- an ownership instrument that is mandatorily redeemable upon an event that is uncertain to occur
- an ownership instrument that is puttable upon an event other than retirement or death.

The Board also directed the staff to analyse further how a limited life entity would classify its ownership instruments.

IFRIC

Post-implementation revisions

In January 2009 the Board published an exposure draft *Post-implementation Revisions to IFRIC Interpretations* (ED/2009/1), proposing amendments to IFRIC 9 *Reassessment of Embedded Derivatives* and IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*.

At this meeting, the Board discussed the responses and decided:

- as proposed in ED/2009/1, to amend paragraph 5 of IFRIC 9 to exclude from the scope of IFRIC 9 embedded derivatives in contracts acquired in common control transactions and the formation of joint ventures.
- as proposed in ED/2009/1, to amend paragraph 14 of IFRIC 16 to remove the restriction that the hedging instrument cannot be held by the foreign operation whose net investment is being hedged and to delete paragraph BC24.

In ED/2009/01 the Board proposed that the amendment to IFRIC 16 paragraph 14 should be effective for annual periods beginning on or after 1 October 2008, at the same time as IFRIC 16. Respondents to the exposure draft were concerned that permitting application before the amendment was issued might imply that an entity could designate hedge relationships retrospectively contrary to the requirements of IAS 39. Consequently, the Board decided that an entity should apply the amendment to paragraph 14 for annual periods beginning on or after 1 July 2009. The Board also decided to permit earlier application but noted that early application is possible only if the designation, documentation and effectiveness requirements of paragraph 88 of IAS 39 and IFRIC 16 are satisfied at the application date.

The Board will include these amendments in *Improvements to IFRSs*, expected to be issued in April 2009.

Update on IFRIC activities

The staff reported on the IFRIC's meeting in March. Details of the meeting are in IFRIC Update, available on the IASB's website.

IFRS for non-publicly accountable entities

Re-exposure

The Board discussed whether there was a need to re-expose the revised draft *IFRS for Non-publicly Accountable Entities* (NPAEs) as a result of the changes made during the Board's redeliberations of the February 2007 exposure draft. The Board considered the changes made in the light of the guidelines for re-exposure in the *Due Process Handbook for the IASB.* The Board decided unanimously that re-exposure was not required.

Implementation and review

The Board asked the staff to develop a plan for implementation and subsequent review of the standard. The plan should address:

- how to deal with issues that arise as entities around the world adopt the new standard for the first time
- how to maintain the standard, particularly in the light of the changes to full IFRSs that are expected on the basis of the IASB's work plan.

Name of the standard

The Board discussed the reaction to its tentative decision in January 2009 that the name of the final standard should be *International Financial Reporting Standard for Non-publicly Accountable Entities*, or *IFRS for NPAEs*. Some Board members observed that the reaction to this name has been somewhat unfavourable because (a) it is expressed in the negative, (b) all entities have some types of accountability to the public and (c) 'non-publicly accountable entity' is a complicated phrase to say and to translate. The Board discussed alternative names and expressed a preference to revert to *IFRS for Private Entities*, *with Simplified IFRSs* as a second preference. Board members will discuss the name with representatives of the national standard-setters at their meeting in April 2009.

Indicative vote on the final standard

The Chairman asked the Board members to indicate how they expected to vote on the final standard. Thirteen Board members indicated an intention to vote in favour, and one to dissent.

Insurance contracts

The Board discussed the cash flows that would be included in a measurement of insurance liabilities. The aim of the session was educational and no decisions were made.

The Board will start discussing policyholder behaviour and policyholder participation in April. The Board will also discuss margins, including subsequent measurement, and how to treat acquisition costs and the part of the premium that recovers those costs.

Post-employment benefits

In January, the Board decided to develop two separate exposure drafts from the proposals in the discussion paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* and the responses to them. At this meeting, the Board continued its discussion of the first exposure draft, which will address recognition and presentation of changes in the defined benefit obligation and in plan assets, disclosures, and other issues raised in the comment letters that can be addressed expeditiously.

Presentation

The Board decided tentatively that an entity should separate changes in the net defined benefit asset or liability into three components:

- service cost
- interest cost on the defined benefit obligation – to be presented in the same way as other finance costs
- remeasurements comprising other changes in the defined benefit obligation and in plan assets – to be presented separately in the income statement net of tax effects.

The Board also decided tentatively that an entity should:

- classify the gain or loss on settlement and the effect of the asset ceiling in the remeasurements component.
- classify the gain or loss on curtailment with service costs.

Other issues

The Board decided tentatively:

- not to provide additional guidance on how to determine the appropriate discount rate. However, when the Board finalises the definition of an 'active market' in its project on fair value measurement, the Board may consider bringing that term and related guidance into IAS 19, to replace the term 'deep market'.
- not to introduce a blanket exemption from defined benefit accounting for multi-employer plans.
- to clarify that an entity should consider expected future increases in salaries when assessing whether benefits attribute higher benefits to later years.
- to clarify that an entity should consider risk-sharing and or conditional indexation features when determining the best estimate of the defined benefit obligation.
- to amend the Basis for Conclusions on IAS 19 to clarify that the definitions of short-term employee benefits and other long-term employee benefits are based on the timing of when the entity expects the benefit to become due to be settled.
- to clarify that tax payable by the plan would be included in the return on plan assets or in the measurement of the obligation depending on the nature of the tax. The staff will consider where costs of administering a plan should be included in the light of this decision.

Next steps

The Board will continue its discussion in April.

Revenue recognition

In the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers*, the Board and the FASB propose a revenue recognition model based on increases in an entity's net contract position. The entity's net contract position is a contract asset or a contract liability depending on the combination of the remaining rights and performance obligations in the contract. In that model, an entity initially measures those rights and performance obligations at the transaction price - ie the amount of promised customer consideration.

The discussion paper does not consider how an entity would determine the transaction price when the promised consideration is (a) paid at a time significantly different from performance by the entity, (b) uncertain or (c) in a form other than cash. At this meeting, the Board discussed these issues.

Time value of money

The Board decided tentatively that:

- an entity's net contract position should reflect the time value of money whenever the effect would be material. In considering whether to provide guidance on materiality in this context, the Board noted that IAS 39 states that short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial.
- the discount rate should be the rate at which the entity and its customer would have entered into a financing transaction that did not involve the provision of other goods and services.
- the effect of financing should be presented separately from the revenue for other goods and services.

Uncertain consideration

The Board considered how an entity should determine the transaction price when the promised customer consideration amount is uncertain for reasons other than the customer's credit risk and modifications of the contract. The Board decided tentatively that:

- at contract inception, the transaction price is the amount of the expected customer consideration—ie the probability-weighted estimate of customer consideration.
- after contract inception, an entity should update the measurement of rights to reflect changes in the transaction price, and allocate those changes to the performance obligations. If changes are allocated to performance obligations that have been satisfied, the effects of the changes should be recognised as revenue. If the effects of the changes relate to obligations that are unperformed, they increase or decrease the measurement of those obligations. The staff will consider further how to allocate a change in the transaction price to performance obligations.

Non-cash consideration

The Board decided tentatively that:

- an entity should measure non-cash consideration at its fair value.
- if an entity cannot estimate reliably the fair value of non-cash consideration, it should measure the consideration indirectly by reference to the fair value of the promised goods and services.
- an entity should not recognise revenue if a transaction lacks commercial substance. The staff will consider further whether an exchange of similar assets (with commercial substance) should generate revenue.

Next steps

The Board will consider collectibility and some contract-related issues (such as renewal and cancellation options, and combining and segmenting contracts) at its meetings in April and May.

Annual improvements

The Board redeliberated one issue from the exposure draft of proposed *Improvements to IFRSs* published in August 2008 on the scope exemption within IAS *39 Financial Instruments: Recognition and Measurement* for business combination contracts. The Board decided tentatively to amend paragraph 2(g) of IAS 39 to limit the scope exclusion to any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to close the transaction. The Board will include this amendment in the *Improvements to IFRSs*, expected to be issued in April 2009.

Updates

The Board received updates on recent meetings of the Standards Advisory Council and the Analyst Representative Group. The staff's summaries of those discussions are available on IASB's website on the SAC meetings section (http://www.iasb.org/About+Us/About+the+SAC/SAC+meetings) and on the ARG meeting page (http://go.iasb.org/ARGMeetingFeb2009).

Joint meeting – IASB and FASB

The IASB held a meeting with the FASB on 23 and 24 March. Building on work underway, the two boards agreed to work jointly and expeditiously towards common standards that deal with off balance sheet activity and the accounting for financial instruments. They will also work towards analysing loan loss accounting within the financial instruments project.

These steps reaffirm a commitment to a joint approach to the financial crisis and to the overall goal of seeking convergence of International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP) described by a Memorandum of Understanding (MoU) first published in 2006 and updated in 2008.

The boards will work together towards common standards by developing the IASB projects on consolidation and derecognition as joint projects once the FASB has completed its short-term amendments to its existing standards. Furthermore, the boards have agreed to publish proposals to replace their respective financial instruments standards with a common standard in a matter of months, not years. As part of this project the boards will examine loan loss accounting, including the incurred and expected loss models.

The boards will continue to draw on expertise provided by the Financial Crisis Advisory Group (FCAG), a high level advisory body formed to guide the boards in their joint response to the financial crisis. The composition of the FCAG includes current and former investors, regulators, central bankers, finance ministers and others from industry and the public sector. The group has met on three occasions and will summarise its recommendations in a report that is expected to be published in the second quarter of 2009.

The meeting covered the following topics:

- Conceptual framework
- Consolidation/derecognition
- Fair value measurement
- Financial instruments – recognition and measurement
- Financial statement presentation
- Loan losses

■ Work plan

Conceptual framework

The boards made the following decisions:

- Each chapter will be published as soon as it is completed.
- The reporting entity concept will be the subject of a separate chapter.
- Each framework will maintain its current hierarchical status (see IAS *8 Accounting Policies, Changes in Estimates and Errors* and FASB Statement No. 162 *The Hierarchy of Generally Accepted Accounting Principles*).
- Current phases of this project will continue to focus on business entities in the private sector (with limited consideration of how the concepts may apply to other types of entities). A later phase will consider whether modifications are needed to address issues or circumstances unique to not-for-profit entities.

In addition, the IASB decided tentatively to amend IAS 8 to reflect the new qualitative characteristics as agreed by the boards. The IASB will expose the proposed amendment for public comment.

Consolidation/derecognition

The boards discussed ways they might meet their MOU commitments relating to derecognition and consolidation.

The boards noted that the FASB will issue final Statements amending Statement 140 and Interpretation 46(R) in 2009, with expected effective dates of 2010. The boards also noted that the IASB will publish in the next few days an exposure draft that would replace existing requirements on derecognition of financial instruments. The IASB has already published an exposure draft of proposed requirements for consolidation.

The boards decided that they would deliberate the issues raised by constituents in comment letters with the objective of reaching common conclusions following the close of the comment period on the IASB's two exposure drafts. At the conclusion of those redeliberations, the IASB would issue standards for derecognition and consolidation. The FASB would publish exposure drafts for public comment on both topics.

Fair value measurement

The boards received an update on the IASB's project on fair value measurement. This session was educational and no decisions were made. The IASB has completed its deliberations, subject to any matters that arise in drafting. The IASB expects to publish an exposure draft early in the second quarter of 2009.

Financial instruments – recognition and measurement

The boards discussed:

- the objectives of the project;
- potential measurement methods for financial instruments; and
- potential characteristics for categorising financial instruments.

The boards decided that the objective of the project is to replace their respective financial instruments standards with a common standard that will significantly improve the decision-usefulness for users of financial statements. The boards believe that improving the decision-usefulness will also lead to simpler accounting requirements. The boards decided that, although the project objective is comprehensive, the project should be addressed expeditiously.

The boards decided to consider at a future meeting three potential measurement methods:

- fair value - defined as an exit price in FASB Statement 157 *Fair Value Measurements* and in the forthcoming IASB exposure draft on fair value measurements;
- another remeasurement method based on discounted cash flows (which the boards will define at a future meeting); and
- amortised cost.

To help in categorising which, if any, financial instruments should be subject to each of those measurement methods, the boards discussed the following possible criteria:

- characteristics of the instrument, such as cash flow variability
- business model of the entity
- the entity's intention and/or ability to trade the instrument.

Financial statement presentation

The boards discussed the design of the field test of the presentation model proposed in the October 2008 discussion paper, *Preliminary Views on Financial Statement Presentation*. As part of that field test, participant companies are recasting two years of financial statements using the principles and application guidance in the discussion paper and completing a survey about that recasting exercise.

The staff provided a preliminary overview of the results received thus far and of quantitative information about how the participant companies' financial statements changed as a result of applying the proposed model. Once all of the field test companies have completed the recasting exercise, analysts will review both recast and non-recast financial statements and respond to a survey.

After the analyst portion of the field test is complete and all the results summarised, the boards will discuss the field test results at a public meeting. The current plan is to hold that meeting in July 2009 and to begin redeliberating the proposed presentation model in September 2009.

Loan losses

In the current financial crisis, some have advocated that financial reporting standards should require new forms of accounting for loan losses, eg 'dynamic provisioning' or expected loss accounting. At this meeting, the boards began a discussion on how to account for loan losses. They explored and compared the incurred loss model and an expected loss model. Both models:

- use amortised cost conventions rather than fair value
- attempt to identify losses on existing loans, not losses that might exist on future loans.

The boards directed the staff to explore further the dynamic provisioning model used by the Spanish Central Bank.

The boards noted that prudential regulators might require financial institutions to reserve amounts of capital. The boards observed that those amounts would result from restrictions on capital or appropriations of profit and, thus, would not appear in the statement of comprehensive income (or separate income statement, if presented). The boards also noted that any display in the financial statements of such restrictions or appropriations needs to be transparent.

The boards also noted that loan loss provisioning is relevant to the project on financial instruments – recognition and measurement (see above) and that future work on loan losses should be part of that project.

Work plan

In February 2006 the boards published a Memorandum of Understanding (MoU) setting out priorities within their joint work plan. In September 2008 they published a progress report on the MoU. At this meeting the boards reviewed progress on the projects covered by the MoU. No decisions were made.

Future Board meetings

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

2009

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, Norwalk USA)

16-20 November

14-18 December

