IASB Update

From the International Accounting Standards Board

1 June 2010

Welcome to IASB Update

This IASB Update is a staff summary of the tentative decisions reached by the Board at a public meeting. As a project progresses, the Board can, and sometimes does, modify its earlier tentative decisions. Tentative decisions do not change existing requirements until those decisions are incorporated in a new or amended standard.

The International Accounting Standards Board met in London on 1 June 2010 for an additional Board meeting. The US Financial Accounting Standards Board (FASB) participated via video conference. The boards discussed:

- Consolidation
- Insurance contracts
- Leases

Consolidation

The IASB and FASB discussed the disclosure requirements for consolidated subsidiaries and unconsolidated structured entities. The boards tentatively decided that the final disclosure requirements should include a list of disclosure objectives. Specifically, the boards decided that a reporting entity should disclose information that helps users of financial statements to understand:

a. the significant judgements and assumptions (and changes to those judgements and assumptions) made by the reporting entity in determining whether it controls (or does not control) another entity, and/or in determining the reporting entity's involvement with structured entities;
b. the interest that the non-controlling interests have in the group's activities;
c. the effect of restrictions on the reporting entity's ability to access and use assets, or to settle liabilities of consolidated entities, when these restrictions are as a result of where the assets or liabilities are held in the group;
d. the nature of, and changes in, the risks associated with the reporting entity's control of consolidated structured entities or from its involvement with unconsolidated structured entities.

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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 2010 are:

10 June
14 - 18 June
19 - 23 July

To see all Board meetings for 2010, **click here**.

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To achieve these objectives, in addition to the disclosures discussed at previous meetings, the boards tentatively decided to require a reporting entity to disclose the following information:

a. When a reporting entity has an arrangement that might require the reporting entity to provide financial support to a consolidated structured entity (for example, liquidity arrangements and obligations to purchase assets), the reporting entity should disclose the terms of the arrangement, including any possible events or circumstances that could expose the reporting

entity to a loss.

b. When a reporting entity is involved with unconsolidated structured entities, the reporting entity should disclose:

   i. the carrying amount of the assets and liabilities recognised in the reporting entity's consolidated financial statements relating to the involvement;
   ii. the line items in the consolidated statement of financial position in which those assets and liabilities are recognised;
   iii. the amount that best represents the reporting entity's maximum exposure to loss from that involvement, including how the maximum exposure to loss is determined. (If a reporting entity cannot quantify its maximum exposure to loss from its involvement with unconsolidated structured entities it must disclose that fact); and
   iv. a comparison of the carrying amount of the assets and liabilities of the reporting entity that relate to the reporting entity's involvement with unconsolidated structured entities with the reporting entity's maximum exposure to loss.

The boards asked the staff to conduct further research on the scope of these disclosure requirements for involvement with structured entities, and asked the staff to determine whether the disclosures required for involvement with structured entities should apply to involvement with all entities.

The IASB completed discussions about the disclosure requirements for a reporting entity that meets the proposed definition of an investment company.

The Board tentatively decided to include a requirement for an investment company to present a financial highlights schedule in the notes to the financial statements. This schedule would present per share investment income or loss, realised and unrealised gains and losses per share, distributions to shareholders, purchase premiums, redemption fees, payments by affiliates, expense and net investment income ratios, total return and capital commitments.

Insurance contracts

At this meeting the IASB and FASB discussed:

- Transition; and
- the measurement of insurance contracts assumed in a portfolio transfer and in a business combination.

The discussion was in the context of the tentative decisions made by the boards in May when, by a narrow margin, the IASB tentatively selected an approach that includes a risk adjustment plus a residual margin and, by a narrow margin, the FASB tentatively selected an approach that includes a single composite margin.

Transition

The boards tentatively decided that, at the beginning of the earliest period presented, for each portfolio of insurance contracts already exists at that date, an insurer:

- should measure that portfolio at the expected present value of cash flows arising from the portfolio of contracts plus a risk adjustment. The risk adjustment would be included not only when using the approach that uses a separate risk adjustment (the IASB's approach), but also in the approach that uses a single composite margin (the FASB's approach).
- should recognise in opening retained earnings the difference between that measurement and the measurement under the insurer's previous accounting policies.
- should not include a residual margin.
- for the approach that uses a single composite margin, the insurer should treat the risk adjustment determined at the beginning of the earliest period as the composite margin at that date. The insurer should disclose the subsequent run-off of that composite margin separately

from disclosure of the run-off of composite margins arising after transition.

- should derecognise any intangible assets arising from insurance contracts assumed in previously-recognised business combinations, with a corresponding adjustment to retained earnings. (That adjustment would not affect intangible assets, such as customer relationships and customer lists, which relate to possible future contracts.) Similarly, an insurer should derecognise any existing balances of deferred acquisition costs, with a corresponding adjustment to retained earnings. The boards noted that previously-recognised intangible assets and deferred acquisition costs could both be viewed as corrections for a previous overstatement of the insurance liability, and so their elimination is likely to coincide with a reduction in the measurement of the insurance liability.

The boards also addressed the disclosure requirements on transition date and tentatively decided:

- to exempt an insurer from disclosing previously-unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed standard.
- not to require specific disclosures about transition, beyond those already required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and FASB ASC Subtopic 250-10-50 *Accounting Changes and Error Corrections - Disclosure for changes in accounting policy*.

The boards also tentatively decided that an entity issuing insurance contracts should be permitted, when it adopts the future insurance contracts standard, to redesignate a financial asset as measured at fair value through profit or loss at the start of the earliest period presented, if doing so would eliminate or significantly reduce an inconsistency in measurement or recognition. The entity should recognise the cumulative effect of that redesignation as an adjustment to opening retained earnings of the earliest period presented and remove any related balances from accumulated other comprehensive income.

Finally, the IASB tentatively decided that first-time adopters of IFRSs should be subject to the same transitional arrangements as proposed for entities that already apply IFRSs.

The boards did not discuss the effective date, nor whether to permit early adoption. The boards plan to consider those matters collectively for standards to be completed by 30 June 2011. The staff reminded the boards that in developing the requirements published on November 2009 in IFRS 9 *Financial Instruments*, the IASB noted that it would consider delaying the effective date of IFRS 9 if the new IFRS on insurance contracts had a mandatory effective date later than 2013, so that an insurer would not have to face two rounds of changes in a short period.

Portfolio transfers and business combinations

The IASB tentatively decided that, on the date of the transfer, for each portfolio of insurance contracts assumed, an insurer should:

- determine the expected present value of the cash flows [plus the risk adjustment, in the model that uses such an adjustment]; and
- compare that amount with the consideration received for those contracts (after adjusting the consideration for any other assets and liabilities acquired in the same transaction, such as financial assets and customer relationships), treating the difference as follows:
    - if the consideration is the higher amount, the insurer should treat the difference as the [residual margin] [composite margin] at that date;
    - if the consideration is the lower amount, the insurer should recognise that difference in profit or loss at that date.

The FASB tentatively decided that, on the date of the transfer, for each portfolio of insurance contracts assumed, an insurer should:

- determine the expected present value of the cash flows [plus the risk adjustment, in the model that uses such an adjustment]; and

compare that amount with the consideration received (after adjusting the consideration for any other assets and liabilities acquired in the same transaction, such as financial assets and customer relationships), treating the difference as the residual or composite margin at that date.

The boards also addressed the measurement of insurance contracts that were assumed in a business combination and tentatively decided that an insurer should:

- compare the expected present value of the cash flows from those contracts [plus the risk adjustment, in the model that uses such an adjustment] with the fair value of those contracts, treating the difference as follows:
- if the fair value is the higher amount, the insurer would treat the difference as the [residual margin] [composite margin] at that date;
- if the fair value is the lower amount, the insurer would measure the contracts initially at the expected present value of the cash flows [plus the risk adjustment, in the model that uses such an adjustment], rather than their fair value. This exception from the general requirement in IFRS 3 *Business Combinations* and ASC Topic 805 *Business Combinations* would increase the initial carrying amount of goodwill recognised in the business combination.

Next steps

The IASB will continue their discussion of this project at the joint board meeting on 10 June.

Leases

The IASB discussed whether it had complied with the due process steps listed in paragraphs 110-111 of the *IASB Due Process Handbook* (the 'Comply or explain' approach) in the leases project.

At this meeting, the Board concluded that:

- it has performed all mandatory due process steps necessary to issue an exposure draft; and
- it has performed sufficient non-mandatory due process steps to issue an exposure draft.

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