

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 24 August 2010. The topics discussed were:

- Amortised cost and impairment
- Hedge accounting
- Income tax

Amortised cost and impairment

At this meeting, the Board continued its redeliberations on phase II of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

User feedback summary

At this meeting, the staff presented the feedback received from users on the exposure draft *Financial Instruments: Amortised Cost and Impairment*. The feedback was gathered during the ED's 8-month comment period from comment letters, user outreach meetings and a web-based user questionnaire.

Approach for redeliberation

The staff also presented the general approach for redeliberations. The staff intend first to address the impairment approach in the context of open portfolios. Following that, they will address the suitability of applying the approach for open portfolios to other situations and any other specific issues will be addressed. At the same time, they will also address any other specific issues.

The impairment approach

At this meeting, the Board discussed what the impairment approach should be in the context of amortised cost measurement. The Board discussed the following different impairment approaches:

- expected loss approach;
- incurred loss approach;
- fair value-based approach; and
- IAS 36 *Impairment of Assets* based approach.

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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:

13 - 17 September
18 - 22 October

To see all Board meetings for 2010, [click here](#).

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The Board tentatively decided to move forward using an expected loss impairment approach.

Scope of expected loss: outlook periods and conditions

The Board also discussed the scope of expected loss (ie what outlook period and what conditions to consider when determining an expected loss).

Outlook period

The Board tentatively decided to consider an expected loss approach based on lifetime expected losses. The Board considered that using a shorter outlook period for determining expected losses would ignore some credit losses and convey an incomplete picture of profitability and the pricing of the financial assets.

Conditions

The Board discussed the following alternatives on the conditions to consider when calculating expected loss:

- through-the-cycle approaches;
- determine expected loss based on past and existing conditions only; and
- consider all reasonable and supportable information and conditions ('full scope' expected loss).

The Board tentatively decided that entities should consider all reasonable and supportable information (including forecasts of future conditions) when calculating expected losses. The Board considered that this approach would allow entities to portray the economic profitability of the lending transactions faithfully. This approach is also consistent with estimating cash flows projects for calculating value in use in IAS 36.

Hedge accounting

Hedge effectiveness testing

At this meeting the Board continued its discussions of hedge effectiveness testing (ie whether a hedging relationship qualifies for hedge accounting). The Board considered a staff paper summarising the approach to effectiveness testing that had been discussed at previous meetings.

The Board tentatively agreed on a hedge effectiveness testing approach as follows:

- The objective of the effectiveness assessment is to ensure that the hedging relationship will produce an unbiased result and minimise expected ineffectiveness. Thus, for accounting purposes hedging relationships should not reflect a deliberate mismatch between the weightings of the hedged item and of the hedging instrument within the hedging relationship.
- In addition to that objective, hedging relationships are expected to achieve offsetting of changes between the hedged item and the hedging instrument that are attributable to the hedged risk (other than accidental offsetting).
- The assessment is forward looking and is performed at inception and on an ongoing basis.
- The type of assessment (quantitative or qualitative) depends on the relevant characteristics of the hedging relationship and on the potential sources of ineffectiveness. The main source of information to perform the effectiveness assessment is entities' risk management.
- No particular methods for assessing hedge effectiveness are prescribed. However, the method used should be robust enough to capture the relevant characteristics of the hedging relationship including the sources of ineffectiveness.
- Changes in the method for assessing effectiveness are mandatory if there are unexpected sources of ineffectiveness (ie new sources not initially anticipated), or if, upon a rebalancing in the hedging relationship, the method previously used is no longer capable of capturing the sources of ineffectiveness and is therefore now not capable of demonstrating whether the hedge produces an unbiased result and minimises ineffectiveness.

Eligible groups of hedged items

At this meeting the IASB discussed whether part of a group of existing items (eg part of a group of firm commitments, debt instruments, etc), could be identified as a 'layer' of the group for the purpose of designation as a hedged item. (A layer is a nominal amount that consists of some items of a population that share the same risk, eg a fixed nominal amount of purchases denominated in a foreign currency that equates to the first 7 out of 10 similar firm commitments that are fulfilled.)

The Board considered specific examples. For the type of examples presented, the Board tentatively decided that when an entity's risk management strategy is to hedge a layer of a group of existing items, any hedge designation for accounting purposes must be on the same basis.

Hedge accounting for investment in equity instruments at fair value through OCI

At this meeting, the Board discussed whether investments in equity instruments classified as at fair value through other comprehensive income (OCI) in accordance with IFRS 9 *Financial Instruments* should be eligible for hedge accounting.

IAS 39 *Financial Instruments: Recognition and Measurement* requires that the exposure hedged by a fair value hedge or a cash flow hedge could affect profit or loss. Hence, if an exposure affects OCI (rather than profit or loss) an entity cannot achieve hedge accounting because any related hedge would not meet the definition of a hedging relationship.

The Board noted that this issue related to the much broader issue of the use of OCI. The Board also noted that permitting hedge accounting for such equity investments would necessitate a different hedge accounting approach than the approach in IAS 39, and would differ from the revised approach that the Board is currently developing. The Board tentatively decided to propose prohibiting the application of hedge accounting to investments in equity instruments designated as at fair value through OCI.

Income tax

At this meeting, the Board discussed a summary of feedback received on the pre-ballot draft of the exposure draft *Deferred Taxes: Recovery of Underlying Asset*. This draft had been circulated in response to the Board's tentative decision in July 2010 to introduce an exception to the measurement principle in paragraph 52 of IAS 12 *Income Taxes*.

In order to address the concerns raised in the feedback, the Board tentatively decided that the exception should:

- a. apply when the expected manner of recovery of certain underlying assets is difficult and subjective to determine;
- b. apply when deferred tax assets or deferred tax liabilities arise from:
 - i. investment property that is measured at fair value in accordance with IAS 40 *Investment Property*; and
 - ii. property, plant and equipment or intangible assets that are measured using the revaluation model in IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*;
- c. be applied equally to both deferred tax assets and deferred tax liabilities;
- d. measure deferred taxes based on the tax consequences following the rebuttable presumption of recovery of the carrying amount of the underlying asset entirely by sale;
- e. be required, rather than permitted, to be applied, unless an entity consumes the asset's economic benefits throughout its economic life; and
- f. propose the withdrawal of SIC Interpretation 21 *Income Taxes - Recovery of Revalued Non-Depreciable Assets*.

The Board also tentatively decided to ask in the exposure draft whether any specific transition guidance is necessary when the amendment is applied to previous business combinations.

Next steps

The Board instructed the staff to prepare the exposure draft *Deferred Taxes: Recovery of Underlying Asset*, reflecting these tentative decisions. The Board plans to publish the exposure draft for comment in early September with a 60-day comment period.

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