IASB Update

From the International Accounting Standards Board

December 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 (IASB)/US Financial Accounting Standards Board (FASB) joint board meeting and the IASB Board meeting took place between 13 - 17 December 2010.

The topics discussed at the joint IASB/FASB board meeting were:

- Asset and liability offsetting
- Fair value measurement
- Financial instruments: hedge accounting (education session)
- Financial instruments: impairment
- Insurance contracts (education session)
- Revenue recognition

The topics discussed at the IASB Board meeting were:

- Consolidation
- Fair value measurement
- Financial instruments: impairment
- IFRS 1 - severe hyperinflation
- IFRS Advisory Council update
- Post-employment benefits

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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 2011 are:

17-21 January
14-18 February
14-18 March (joint 21-23 in London)

To see all Board meetings for 2011, click here.

Archive of IASB Update Newsletter

Click here for archived copies of past issues of IASB Update on the IASB website.

Podcast summaries

To listen to a short Board meeting audio summary (podcast) or previous Board meetings, click here.

Asset and liability offsetting

The IASB and the FASB discussed the following issues:

1. Whether offsetting should be permitted for multilateral arrangements
2. Transition requirements and the comment period for the next due process document.

The boards tentatively decided the following:

1. An entity would be required to offset a recognised financial asset and financial liability if the criteria for offset were met, irrespective of whether the right of offset arises from a bilateral

arrangement (between two parties) or from a multilateral arrangement (that is, between more than two parties).
2. An entity would be required to apply the proposed requirements retrospectively.

The boards also decided that an entity should provide information about financial assets and liabilities subject to offset, and related arrangements (such as collateral agreements), and the effect of those arrangements on an entity's net exposure, by category of financial instrument, including:

a. the gross carrying values (ie before taking into account amounts offset in the statement of financial position and other mitigating factors).
b. shown separately,
    i. the amounts offset under the offset criteria in paragraph 3 to determine the carrying amounts in the statement of financial position and
    ii. the net carrying amount reported in the statement of financial position.
c. shown separately, the portion of the net carrying amount reported in the statement of financial position that is covered by each type of conditional and legally enforceable right of set-off.
d. shown separately, the following types of collateral:
    i. amount of cash obtained or pledged as collateral in respect of those assets and liabilities,
    ii. the carrying amount of other financial instruments pledged as collateral and
    iii. the fair value of other financial instruments received as collateral.
e. the net exposure after taking into account the effect of the items in (b)-(d).

Such information should be presented in a single note and in a tabular format, unless another format is more appropriate. Additionally, financial assets and financial liabilities should be disclosed separately.

Additionally, the boards decided that an entity would also be required to provide a description of the nature of offset agreements for the amounts included in item (3) above.

The boards directed the staff to prepare an exposure draft for vote by balloting.

Fair value measurement

Measuring the fair value of a liability issued with an inseparable third-party credit enhancement

The IASB and the FASB tentatively decided that the requirements for measuring the fair value of a liability issued with an inseparable third-party credit enhancement:

- apply only to guarantees purchased by the issuer of the liability; and
- do not apply to liabilities guaranteed by other entities within the consolidated or combined group.

When an entity is measuring the fair value of a liability issued with an inseparable third-party credit enhancement, the boards tentatively decided that the unit of account is the obligation without the credit enhancement, which means that the entity should measure the fair value of the liability using its own credit standing, not that of the third-party guarantor.

For the FASB, the above tentative decisions confirm principles that are already included in Topic 820 *Fair Value Measurements and Disclosures*, and will result only in clarifications of wording to be consistent with IFRSs. For the IASB, the tentative decisions are consistent with the proposals in the IASB's exposure draft *Fair Value Measurement*.

The IASB also tentatively decided that an entity would be required to disclose the existence of a third-party credit enhancement of a liability that it has issued, as is currently required by US GAAP.

Disclosures about fair value-based measures (such as fair value less costs to sell)

The boards tentatively decided that the disclosures that an entity is required to make about fair value measurements also apply to fair value-based measurements (eg fair value less costs to sell). These disclosures are currently required by US GAAP and are consistent with those proposed in the IASB's exposure draft, but Topic 820 and the IASB's forthcoming fair value measurement standard will be made more explicit.

Financial instruments: hedge accounting (education session)

At this education session, the proposals contained in the IASB exposure draft *Hedge Accounting* were outlined for the FASB. No decisions were made.

Financial instruments: impairment

The IASB and the FASB discussed feedback from outreach on the operational feasibility of the impairment model tentatively supported by the boards during the 8 December 2010 joint meeting. That model as developed initially would have required entities to recognise the higher of a 12-month expected loss estimate and a time-proportionate allowance balance calculated as the entity's allowance for losses for the 'good' book. This meant that the 12-month expected loss estimate would establish a floor for the 'good' book allowance. The model also required recognising impairment in the 'bad' book to cover fully lifetime expected losses. The boards asked the staff to undertake some outreach to investigate further the operationality of the model and to consider further whether the floor should be a 12-month expected loss estimate or a loss estimate based on the amount of credit losses expected to occur within the foreseeable future.

In the light of this outreach, the boards tentatively decided to change the floor calculation in the model from a 12-month expected loss estimate to a loss estimate based on the amount of credit losses expected to occur within a period that can be reliably estimated as being no less than 12 months. The boards agreed to publish a supplemental document seeking input from constituents on this model. The boards expect publication of the document in January 2011.

Insurance contracts (education session)

The IASB and the FASB considered background material in preparation for their discussions on the issues raised in response to the IASB's exposure draft *Insurance contracts* and the FASB's discussion paper *Preliminary Views on Insurance Contracts*, including:

- a proposed project timetable intended to enable the IASB to finalise a standard on insurance contracts, and the FASB to finalise an exposure draft, by June 2011.
- material reminding the boards of the reasons why they developed a standard on insurance contracts and the proposed measurement model.
- a summary of feedback received during outreach activities during the comment period and an overview of the main issues raised.

The boards did not make any decisions.

Next steps

At the January 2011 meeting, the boards expect to consider a comment letter analysis and to continue their discussions on the accounting for insurance contracts.

Revenue recognition

The IASB and FASB considered a summary of:

- the responses to the exposure draft *Revenue from Contracts with Customers* that was published in June 2010, and

- outreach activities undertaken in the last seven months.

The boards also approved the plan for redeliberating the issues raised by respondents to the exposure draft.

The boards will begin redeliberations in January 2011 by considering the two fundamental issues raised by respondents: separating a contract and determining when goods or services are transferred to a customer.

The topics discussed at the IASB meeting were:

Consolidation

The IASB discussed the feedback received at the FASB round-table meetings on the IASB staff draft *Consolidated Financial Statements* and the staff's proposals for how to address the concerns raised. The staff proposed providing clarifications in respect to the control principle, potential voting rights and the principal agent guidance. For details on the feedback received from those meetings and the staff's recommendations please refer to Agenda Paper 13A. The Board decided to proceed with finalising IFRS 10 *Consolidated Financial Statements* subject to the recommended clarifications noted in Agenda Paper 13A with one exception. Although, the Board tentatively agreed to include explanations in the Basis for Conclusions that security laws and regulations of different jurisdictions can have a significant influence on the rights of the shareholders and are therefore likely to affect the assessment of control, the Board did not agree to include an explanation that would refer to the capital market environment and cultures.

At the meeting the Board also discussed the effective date for IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, and IAS 28 *Investments in Associates* (as amended through the Joint Venture Project). The Board decided to defer its decision on the effective date on these forthcoming standards but tentatively agreed that it should not be earlier than 1 January 2013. The Board will discuss the effective date of those standards as well as their early application as part of the broader consideration of the feedback received from the consultation on the *Request for Views on Effective Dates and Transition Methods*.

Fair value measurement

Scope of disclosures about fair value measurements

The IASB discussed whether the disclosures about fair value measurements should apply to plan assets measured at fair value in IAS 19 *Employee Benefits* and to impaired assets with a recoverable amount based on fair value less costs to sell as defined in IAS 36 *Impairment of Assets*.

The Board tentatively decided to exclude plan assets measured at fair value in IAS 19 from the scope of the fair value disclosure requirements. Disclosures about the fair value of plan assets would be addressed in IAS 19.

The Board also tentatively decided to require the following information when an entity recognises an impairment loss in accordance with IAS 36 and the recoverable amount of an asset (or a group of assets) is determined on the basis of fair value less costs to sell (in addition to what IAS 36 currently requires):

- amount of the fair value measurement;
- level of the fair value measurement within the fair value hierarchy;
- if applicable, changes to valuation techniques and reasons for those changes; and

- quantitative information about significant inputs used in measuring fair value.

The Board also asked the staff to assess further whether it is necessary to require an entity to disclose whether the highest and best use of the asset measured at fair value differs from the current use of the asset. The Board thinks that a difference between highest and best use and current use is likely to be the main reason that fair value less costs to sell is greater than value in use.

These disclosures are consistent with the disclosures about non-recurring fair value measurements currently required in US GAAP and with those that will result from the decisions reached in the joint discussions by the IASB and the FASB.

The Board instructed the staff to begin drafting an IFRS on fair value measurement. The Board will make a decision on the effective date of the IFRS at a future meeting, after the Board has received comments on the Request for Views *Effective Date and Transition Methods*. Comments on that document are due by 31 January 2011.

Financial instruments: impairment

The IASB confirmed the previous direction provided to staff and discussed off balance sheet items, presentation and disclosures.

In the IASB meeting on 1 December, the Board had provided direction to staff on how to continue to develop the impairment model, but it had not made any tentative decisions on the issues. In this meeting the Board tentatively confirmed the previous direction provided as follows:

- short-term trade receivables should be excluded from the scope of the upcoming document;
- the scope of the upcoming document will focus on open portfolios of financial assets, but the document will include a question soliciting specific feedback on the applicability of the model to other instruments (including closed portfolios and single instruments);
- for the 'good' book the time-proportionate amount of the revised lifetime expected loss (EL) estimate will be allocated to the relevant period using either a straight-line approach (that could be applied to a discounted or undiscounted measurement of EL) or an annuity approach. The upcoming document will include a question as to whether a particular approach should be required. When discounting EL, entities may use a discount rate that lies between the risk-free rate and the effective interest rate as determined under IAS 39 *Financial Instruments: Recognition and Measuremen*t; and
- loans would be included in the 'good' book or the 'bad' book according to the entity's internal credit risk management criteria supplemented by an objective that if the uncertainty about collectability has taken precedence over the profitability from the interest margin the asset should be included in the 'bad' book.

The Board also discussed the scope of the upcoming document and tentatively decided to ask a question about whether loan commitments that are not measured at fair value should be included within the scope of the finalised impairment requirements. The Board also tentatively decided that the upcoming document should explain the effect of the proposal on financial guarantee contracts and provide the background, which consists of the related redeliberations as part of the Board's project on insurance contracts.

The Board tentatively decided on the following presentation and disclosure requirements based on the model developed for open portfolios:

- In the statement of comprehensive income, interest revenue will be presented based on the effective interest rate as determined under IAS 39 *Financial Instruments: Recognition and Measurement* and impairment expense will be a separate line item.

- Examples will be included in the upcoming document to provide additional guidance on the level of aggregation that can be considered appropriate for disclosures of credit risk within the principles set out in IFRS 7 *Financial Instruments: Disclosures*.
- The proposed disclosures can be incorporated by cross-reference to other statements that are publicly available to users on the same terms as the financial statements and at the same time.
- For the allowance account for credit losses, an entity should disclose
  - separate reconciliations for the allowance accounts for the 'good' book and the 'bad' book;
  - if losses expected to occur within the upcoming period are higher than the target allowance for the good book, the additional provision amount; and
  - a reconciliation of the nominal amounts of loans in the 'bad' book.
- For the 'good' book, disclosure of the following information in tabular format for the past five years would be required:
  - lifetime EL;
  - balance of the outstanding nominal amount;
  - target allowance balance; and
  - additional provisions to reach the floor (if applicable).
- If a particular portfolio or geographical area has significant effects on the gains and losses, an entity shall disclose quantitative and qualitative analyses of the gains and losses.
- For credit risk management and the distinction between the 'good' book and 'bad' book, the following disclosures would be required:
  - a qualitative analysis of how loans are managed in both books;
  - inclusion of the criteria set for transferring loans from the 'good' book to the 'bad' book;
  - if an entity uses an internal credit rating system, information about that system; and
  - how the internal credit rating grades are assigned to both books.
- An entity would disclose the nominal amount and information about EL (both lifetime EL and credit losses expected to occur in the upcoming period) across a sufficient number (but not more than the number of grades used internally) of credit risk rating grades to allow meaningful differentiation of EL across the different credit grades. At a minimum, an entity would have to differentiate between a 'good' book and a 'bad' book.
- For both lifetime EL and credit losses expected to occur in the upcoming period, the following disclosures would be required:
  - the basis of inputs and the estimation technique used to determine the credit losses;
  - an explanation of any changes in estimates and the reason for the change; and
  - an explanation of any changes in estimation technique and the reason for the change.
- In disclosing the comparison of EL with actual outcomes, if an entity performs back testing, it should provide quantitative analysis that compares the actual outcomes with the previous EL estimate. In some instances a qualitative explanation would be required. If an entity does not perform back testing, it should disclose a qualitative analysis of EL and the actual outcomes.
- For presentation of transfers from the 'good' book to the 'bad' book, a provision for credit losses reflecting the part attributable to the loan transferred to the 'bad' book would be transferred from the good book to the bad book.
- Disclosures regarding the sensitivity of assumptions would not be required.

The Board gave permission to the staff to begin drafting a document for exposure. There will be further discussions with the FASB on whether the disclosures discussed will be included within the main document or documented separately

IFRS 1 - severe hyperinflation

The IASB deliberated the comments received on the exposure draft *Severe Hyperinflation* (Amendment to IFRS 1) published in September 2010. In order to provide guidance for entities emerging from a period of severe hyperinflation, the Board agreed to add an exemption to IFRS 1 *First-time Adoption of International Financial Reporting Standards* that allows entities to resume presenting IFRS financial statements or to present IFRS financial statements for the first time, by permitting the entity to measure all assets and liabilities held before the functional currency normalisation date at fair value on the date of transition to IFRSs. The entity taking this exemption would use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

The Board also agreed that the amendment should have an effective date of 1 July 2011, with early application permitted.

The Board issued the amendment on 20 December 2010.

IFRS Advisory Council update

Alan Teixeira gave, on behalf of Paul Cherry, the Chairman of the IFRS Advisory Council, an oral update of the IFRS Advisory Council meeting held in London in November. A recording of the meeting is available here and a staff summary will be available on the IASB website shortly.

Post-employment benefits

The IASB discussed the proposals in the exposure draft *Defined Benefit Plans* relating to settlements and curtailments, multi-employer plans and other matters addressed in the exposure draft or arising from the comment letters on the ED.

Settlements and curtailments

The Board tentatively decided:

- to amend the definition of curtailment to limit it to a significant reduction in the number of employees covered by a plan. The definition of a curtailment would no longer include a reduction in benefits for future service. However, in some cases, past service cost arises if a change in benefits for future service results in a change in benefits attributed to past service.
- to amend the definition of settlements to exclude plan amendments that result in past service cost and curtailments and to amend the definition of non-routine settlements to exclude benefit payments in accordance with the terms of the plan.
- to require past service cost and gains and losses on curtailments and non-routine settlements to be presented in the service cost component.
- to require gains and losses on routine settlements to be presented in the remeasurements component.
- to confirm the proposals in the exposure draft for the disclosure of past service cost, curtailments and non-routine settlements but not to require distinguishing between these items if they occur together and are presented in the same component.

Multi-employer plans

The Board tentatively decided:

- to retain the requirement in IAS 19 *Employee Benefits* that an entity should account for its participation in a defined benefit multi-employer plan in the same way as for any other defined benefit plan unless insufficient information is available, in which case an entity should account for the plan as if it were a defined contribution plan;
- to confirm the disclosure requirements proposed in the exposure draft for multi-employer plans, but amended to limit the disclosure of the withdrawal liability to qualitative information and to specify that an entity should recognise and measure any withdrawal liability in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
- to confirm the disclosures proposed in the ED for multi employer plans treated as if they were defined contribution plans with the following amendments:
  - to reduce the period for the required disclosure of future contributions from 5 years to 1 year.
  - to require an indication of an entity's level of participation in a plan. Such a requirement could be met by disclosing the proportion of total members or the proportion of total contributions.

Other issues

The Board tentatively decided:

- to require plan administration costs to be expensed as incurred, for practical reasons. The Board directed the staff to seek feedback on this decision from the Employee Benefits Working Group.
- to confirm the proposals in the ED for the accounting for taxes payable by the plan.
- to confirm the proposed clarification in the ED that mortality assumptions include current estimates of expected changes in mortality.
- to withdraw the proposal in the ED to incorporate IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* into IAS 19.
- to withdraw the proposal in the ED that would have required entities to consider expected future salary increases in determining whether a benefit formula allocates a materially higher level of benefit in later years.
- not to make any additional amendments regarding interim reporting.
- to confirm the proposal in the ED to update the disclosures:
  - for defined benefit state plans to be consistent with the disclosures for defined benefit multi-employer plans if the information for the state plans is available.
  - for group plans to be consistent with the disclosures for defined benefit plans, and for group plans to allow the information to be included by cross-reference to disclosures in the parent's financial statements if:
    - the parent's financial statements separately identify and disclose the information required for the group plan, and
    - the parent's financial statements are available to users of the financial statements on the same terms as the financial statements of the entity and at the same time

Next steps

In January, the Board intends to discuss:

- the timing of recognition of curtailments and settlements,

- accounting for risk-sharing features; and
- transition.

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