IASB Update

From the International Accounting Standards Board

January 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 with the US Financial Accounting Standards Board (FASB) in London on 18 - 20 January 2010, when they discussed:

- **Financial crisis**
  - Consolidation
  - Fair value measurement
  - Financial instruments: classification and measurement
  - Financial instruments: hedge accounting
  - Financial instruments with characteristics of equity
- **Financial statement presentation**
- **Insurance contracts**
- **Leases**
- **Revenue recognition**

The International Accounting Standards Board met in London on 20 - 22 January 2010, when it discussed:

- **Financial crisis**
  - Derecognition
  - Financial instruments: hedge accounting
- **Amendments to IFRS 1**
- **Discontinued operations**
- **Financial statement presentation**
- **IFRIC Update**
- **Post-employment benefits**

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Future board meetings

The IASB meets at least once a month (except in August) for up to five days.
The next Board meetings in 2010 are:

15 - 19 February
2 February (PM)
10 February (PM)
15 - 19 March

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

Archive of IASB Update Newsletter

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Podcast summaries

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

Joint meeting with FASB

Financial crisis

Consolidation

The IASB and the FASB discussed the following issues relating to the control model being developed for the purposes of determining when one entity should consolidate another:

- Control through voting rights (including control with less than half of the voting rights in an entity)
- Options and convertible instruments
- Agency relationships (including kick-out rights)

Control through voting rights

The boards tentatively decided that, when assessing control of entities controlled through voting rights:

- a reporting entity that holds more than half of the voting rights in an entity meets the power element of the control definition, in the absence of other arrangements.
- a reporting entity (with less than half of the voting rights in an entity) that has the legal or contractual ability to direct those activities of the entity that significantly affect the returns meets the power element of the control definition.

The IASB tentatively decided that a reporting entity with less than half of the voting rights meets the power element of the control definition in situations in which the reporting entity holds significantly more voting rights than any other party or organised group of shareholders, and in which the other shareholdings are widely dispersed. The FASB tentatively decided that such a reporting entity must have demonstrated that it has directed the activities of the entity that significantly affect the returns in order to meet the power element of the control definition.

Options and convertible instruments

The boards tentatively decided that a reporting entity should consider options and convertible instruments when assessing whether it has the power through voting rights to direct the activities of an entity that significantly affect the returns. The consideration of whether a reporting entity has the power to direct the activities of the other entity would include not only a reporting entity's voting rights in another entity, but also an assessment of all the facts and circumstances associated with the options or convertible instruments.

Agency relationships

The IASB and the FASB discussed what factors should be considered when determining whether a party that has been delegated decision-making authority should be considered to be an agent. The boards also discussed whether kick-out rights that are exercisable on agreement by more than one unrelated party could be substantive and should be considered when assessing agency relationships. The boards did not reach any decisions on agency relationships. This topic will be discussed further by the IASB and FASB at their February 2010 joint Board meeting.

Go to the project page on the IASB website

Fair value measurement

The boards discussed the following topics:

- Definition of fair value
- Measuring fair value when markets become less active
- Fair value at initial recognition
- Recognition of day 1 gains or losses
- Measuring liabilities at fair value
- Non-performance risk
- Restrictions on the transfer of a liability
- Measuring own equity instruments at fair value
- Market participant view
- Reference market

Definition of fair value

The boards tentatively decided:

- to retain the term 'fair value'
- to define fair value as an exit price. The boards will discuss where that definition should be used in a future meeting when they address the scope of a converged fair value measurement standard.

Measuring fair value when markets become less active

The boards tentatively decided that the guidance for measuring fair value in markets that have become less active:

- pertains to when there has been a significant decline in the volume and level of activity for the asset or liability.
- focuses on whether an observed transaction price is orderly, not on the level of activity in a market.

The boards also tentatively decided that an entity should consider observable transaction prices unless there is evidence that the transaction is not orderly. If an entity does not have sufficient information to determine whether a transaction is orderly, it performs further analysis to measure fair value.

Fair value at initial recognition

The boards tentatively decided that the transaction price might not represent the fair value of an asset or liability at initial recognition if, for example, any of the following conditions exist:

- the transaction is between related parties
- the transaction takes place under duress or the seller is forced to accept the price in the transaction
- the unit of account represented by the transaction is different from the unit of account for the asset or liability measured at fair value
- the market in which the transaction takes place is different from the market in which the entity would sell the asset or transfer the liability.

Day one gains or losses

The IASB tentatively decided not to address the recognition of day one gains or losses as part of the fair value measurement project. The boards will discuss the recognition of day one gains or losses at a future meeting.

Measuring liabilities at fair value

The boards tentatively decided:

- that in the absence of a quoted price in an active market representing the transfer of a liability, an entity measures the fair value of a liability as follows:
    a. using the quoted price of the identical liability when traded as an asset (ie a Level 1 measurement), if that price is available
    b. if that price is not available, using quoted prices for similar liabilities or similar liabilities when traded as assets (ie a Level 2 measurement)
    c. if observable inputs are not available, using another valuation technique such as:
        1. an income approach (eg a present value technique) or
        2. a market approach (eg using the amount that a market participant would pay to transfer the identical liability or receive to enter into the identical liability)

- to describe the compensation a market participant would demand for taking on an obligation in the application of a present value technique
- to clarify that the transfer of a liability assumes that a market participant transferee has the knowledge and ability to fulfil the identical obligation
- that an entity must determine whether the fair value of a liability when traded as an asset (the corresponding asset) represents the fair value of the liability. If an entity determines that the fair value of the corresponding asset does not represent the fair value of the

liability, it must make adjustments to the fair value of the asset to the extent that its fair value does not represent the fair value of the liability
- that the fair value of a corresponding asset represents the fair value of the liability whether or not that asset is traded on an exchange
- that the fair value of the corresponding asset should be measured using the methodology market participants would use
- that a quoted price for a corresponding asset in an active market is also a Level 1 fair value measurement for the liability when no adjustments to that quoted price are required.

Non-performance risk

The boards tentatively decided:

- that the fair value of a liability includes the effect of non-performance risk
- to clarify what, in addition to credit risk, non-performance risk represents.

Restrictions on the transfer of a liability

The boards tentatively decided that the fair value of a liability should not be adjusted further for the effect of a restriction on its transfer if the restriction is already included in the other inputs to the fair value measurement.

Measuring own equity instruments at fair value

The boards tentatively decided to include guidance for measuring the fair value of an entity's own equity instruments in a converged fair value measurement standard.

Market participant view

The boards tentatively decided:

- to confirm that a fair value measurement is market-based and reflects the assumptions that market participants would use in pricing the asset or liability
- that market participants should be assumed to have a reasonable understanding about the asset or liability and about the transaction, based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
- that 'independence' in the description of market participants means that market participants are independent of each other; that is, they are not related parties
- that a price in a related party transaction may be used as an input to a fair value measurement if the transaction was entered into at market terms
- that the unobservable inputs derived from an entity's own data, adjusted for any reasonably available information that market participants would take into account, are considered market participant assumptions and meet the objective of a fair value measurement.

Reference market

The boards tentatively decided:

- that the reference market for a fair value measurement is the principal (or most advantageous) market provided that the entity has access to that market.
- to clarify that:
    a. the principal market is the market with the greatest volume and level of activity for the asset or liability
    b. there is a presumption that the principal market is the market in which the entity normally transacts. Entities do not need to perform an exhaustive search for markets that might have more activity than the market in which they normally transact
    c. the determination of the most advantageous market considers both transaction costs and transportation costs.

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Financial instruments: classification and measurement

Financial liabilities

The boards reviewed their respective prior discussions related to the classification and measurement of financial liabilities. No decisions were made.

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Financial instruments: hedge accounting

The boards discussed possible timelines for completing the hedge accounting phase of the joint

financial instruments project and the issues that might be addressed under each timeline. The boards tentatively decided to address hedge accounting comprehensively. However, in light of the FASB's goal to publish a comprehensive exposure draft on financial instruments in March 2010, and of the IASB's goal to publish in the first quarter of 2010 an exposure draft on the remaining main phases of the project to replace IAS 39, the boards will first jointly consider hedge accounting issues relating to financial hedged items, together with issues that are more directly related to the boards' respective decisions to date on the classification and measurement models for financial instruments.

The boards will subsequently discuss other hedge accounting issues, including hedge accounting for non-financial hedged items and portfolio hedge accounting. The boards expect to address all hedge accounting issues in the first half of 2010.

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Financial instruments with characteristics of equity

The boards decided not to adopt any of the approaches that they have previously considered. Instead, they directed the staff to analyse a possible amendment to IAS 32 *Financial Instruments: Presentation*. The effects of that possible amendment have not yet been specified but the following are some possibilities:

- A requirement to classify as equity shares puttable only if specified certain events occur, such as the death or retirement of the holder
- A requirement to separate some puttable shares into equity and liability components
- A slight relaxation of the provision that to qualify as equity, a financial instrument involving exchanges of equity instruments for cash must require an exchange of a fixed number of shares for a fixed amount of cash.

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Financial statement presentation

The boards continued their deliberations on the proposals in the discussion paper *Preliminary Views on Financial Statement Presentation*. Specifically, the boards considered disaggregation by function and nature and segment disclosures (agenda paper 7A).

Background

The discussion paper proposed that within each category on the statement of comprehensive income, an entity should disaggregate its items of income and expense by function. Each of these functions should be further disaggregated by nature to the extent that such by-nature information enhances the usefulness of the statement of comprehensive income in predicting an entity's future cash flows. If that by-nature presentation is impractical on the face of the statement of comprehensive income, an entity should present the information in the notes to financial statements.

The discussion paper also proposed that if, in the opinion of management, presenting disaggregated information by function does not provide relevant information, an entity can disaggregate its items of comprehensive income by their nature within each category on the statement of comprehensive income.

In October 2009, the boards tentatively decided to retain the discussion paper proposal that an entity should disaggregate income and expense items by nature and by function. Furthermore, an entity with more than one reportable segment should present that disaggregated information in its segment note, while an entity with only one reportable segment should present that disaggregated information on its statement of comprehensive income.

Tentative decisions

At their January joint meeting, the boards tentatively decided that the exposure draft:

- will specify that an entity with only one reportable segment may present its disaggregated by-nature information in a single note disclosure, rather than presenting that information on the statement of comprehensive income. An entity that presents its by-nature information in a note disclosure must also include its by-function information in the same note.
- will specify that an entity with more than one reportable segment must present its disaggregated by-nature information in its segment note, and must also include its by-function information in the same note.
- will specify that an entity that disaggregates income and expense items by both function and nature in the notes to financial statements should present its by-function information on the statement of comprehensive income.
- will retain the discussion paper proposal that an entity should disaggregate its income and expense items in a manner that presents useful information for assessing the amount, timing and certainty of future cash flows. Consequently, if disaggregation by function does not enhance the usefulness for that purpose of the information on the statement of comprehensive income, an entity should instead disaggregate its income and expense items by nature only.

The boards also considered amendments to Accounting Standards Codification Topic 280 *Segment*

Reporting and IFRS 8 *Operating Segments*. The boards tentatively decided that the exposure draft:

- will require an entity that presents by-nature income and expense information in its segment note to classify items consistently between the statement of comprehensive income and the segment note.
- will require an entity to present information about its operating segment activities that do not meet the criteria to be presented as a reportable segment separately from information about its corporate activities;
- will require an entity to reconcile the operating profit (loss) of its reportable segments to its consolidated operating profit presented on the statement of comprehensive income.

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Insurance contracts

The boards discussed the following topics:

- measurement and risk adjustments;
- day-one losses;
- the treatment of the residual margin; and
- policyholder behaviour.

Measurement and risk adjustments

At their joint meeting in December, the boards tentatively decided that the measurement approach should portray a current assessment of the insurer's obligation, using the following building blocks:

- the unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfils the contract;
- the time value of money;
- a risk adjustment for the effects of uncertainty about the amount and timing of future cash flows; and
- an amount that eliminates any gain at inception of the contract.

In this meeting, the boards tentatively decided that:

- these building blocks should be used to measure the combination of rights and obligations arising from an insurance contract rather than to measure the rights separately from the obligations. That combination of rights and obligations should be presented on a net basis.
- the objective for measuring an insurance contract should refer to a value rather than cost. The staff will refine the description of that objective.

The boards also decided tentatively that:

- the risk adjustment should be the amount the insurer requires for bearing the uncertainty that arises from having to fulfil the net obligation arising from an insurance contract. The staff will develop guidance on how to determine the risk adjustment.
- the risk adjustment should be updated (remeasured) each reporting period.

Day-one losses

In the proposed accounting approach, a loss arises at inception if, after applying a risk adjustment, the expected present value of cash outflows exceeds the expected present value of cash inflows. The boards tentatively decided that an entity should recognise that loss in profit or loss at inception.

Treatment of residual margins

The proposed accounting approach eliminates any gain at inception by including a residual margin in the measurement of the combination of rights and obligations arising from the insurance contracts. The boards tentatively decided :

- to develop specific guidance on how the residual margin should be released to profit or loss over time.
- that the insurer should not adjust the residual margin in subsequent reporting periods for changes in estimates.

Policyholder behaviour

The boards discussed features that enable policyholders to take actions that change the amount, timing, uncertainty or nature of benefits that they will receive (policyholder options).

The IASB reaffirmed its view that the policyholder options, as well as options, forwards, and guarantees related to existing coverage, should be included in the measurement of the insurance contract on a look through basis using the expected value of future cash flows (to the extent that those options are within the boundary of the existing contract). As a consequence, no deposit floor would apply. For a future discussion, the staff will develop material to identify the boundary of an existing contract.

The FASB discussed policyholder options. Views diverged and no clear consensus emerged. The

FASB will return to the topic of policyholder behaviour at a future meeting.

The boards also discussed how to treat options, forwards, and guarantees that do not relate to the existing insurance contract coverage. The boards tentatively decided to exclude such features from the measurement of that contract. Instead, those features should be recognised and measured as new insurance contracts or other stand-alone instruments, according to their nature.

Next steps

The boards expect to continue their discussion of this project at an additional joint meeting on 10 February.

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Leases

The boards discussed:

- How to measure leases after initial recognition with options and contingent rentals under the amortised cost-based approach
- Whether to provide a concession for short-term leases; and
- How to account for investment properties held by lessors.

Measurement after initial recognition of leases with options and contingent rentals under amortised cost

The boards tentatively decided that:

- The lessee's discount rate should not be revised when there are subsequent changes in the expected lease term.

- The lessee's discount rate should not be revised when there are subsequent changes in the amounts payable under contingent rentals unless the rentals are contingent on variable reference interest rates.
- The discount rate used by the lessor should not be revised when there are subsequent changes in the expected lease term.
- The discount rate used by the lessor should not be revised when there are subsequent changes in the amounts payable under contingent rentals unless the rentals are contingent on variable reference interest rates.

Concession for short-term leases

The boards tentatively decided:

- to permit lessees to use a simplified form of lease accounting for short-term leases.
- that under this simplified accounting, the lessee would recognise the gross amounts payable and a corresponding right-of-use asset under a short-term lease in the statement of financial position.
- to provide an optional concession for short-term leases for lessors.
- that short-term leases would be defined as those leases that have a maximum possible lease term of less than 12 months.

Investment properties

The boards tentatively decided that the new lessor accounting requirements would be required if the lessor measures its investment properties at cost.

The IASB tentatively decided that if a lessor of investment properties measures its investment properties at fair value in accordance with IAS 40 *Investment Property*, it would not apply the new lessor accounting requirements to the lease.

Because the FASB does not have an option to fair value investment properties, it instructed the FASB staff to prepare an agenda request discussing whether to permit or require investment properties to be carried at fair value under US GAAP.

The boards will continue discussion of lessee and lessor accounting at the February 2010 meeting.

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Revenue recognition

The boards considered the disclosure requirements for the proposed revenue recognition model and tentatively decided:

- to specify a high-level disclosure objective similar to the objectives in FASB ASC Section 605-25-50 *Multiple Element Arrangements-Disclosure* and IFRS 7 *Financial Instruments:*

Disclosures

- to require an entity to disclose:
    a. the nature of contracts that it enters into with customers and the related accounting policies;
    b. the principal judgements used in accounting for contracts with customers;
    c. a reconciliation of the beginning and ending net contract position(s);
    d. the total amount of outstanding performance obligations and the expected timing of their satisfaction; and
    e. information about onerous contracts, including the extent and amount of such contracts and the reasons for them becoming onerous.

Next steps

The boards will continue their discussion of disclosures and consider scope and transition at the forthcoming meetings.

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IASB meeting

Financial crisis

Derecognition

The Board discussed the requirements in IAS 32 *Financial Instruments: Presentation* for offsetting a financial asset and a financial liability. The Board did not make any decisions at this meeting. The Board will continue discussions on the issue at future meetings.

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Financial instruments: hedge accounting

The objective of hedge accounting

The Board discussed two possible objectives for hedge accounting. The Board discussed the possible objectives in the context of whether risk components could qualify for hedge accounting under any hedge accounting approach that the Board might propose. The Board noted that a hedge accounting objective should permit or require hedge accounting for risk components if a risk component is separately identifiable and measurable for the purpose of determining hedge ineffectiveness. The Board also noted that a hedge accounting objective and the treatment of risk components should apply to both financial and non-financial hedged items.

No decisions were made.

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Amendments to IFRS 1

The Board deliberated the comments received on the exposure draft *Limited Exemptions from Comparative IFRS 7 Disclosures for First-time Adopters* (Amendment to IFRS 1) published in November 2009. To avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers, the Board decided that first-time adopters should be permitted to use the same transition provisions permitted for existing preparers of financial statements prepared in accordance with IFRSs that are included in *Improving Disclosures about Financial Instruments* (Amendments to IFRS 7).

Additionally, the Board amended paragraph 44G of IFRS 7 *Financial Instruments: Disclosures* to clarify its conclusions and intended transition for *Improving Disclosures about Financial Instruments* (Amendments to IFRS 7, issued in March 2009). The Board clarified that an entity need not provide comparative information for the disclosures required by the amendments for: (a) any periods presented ending before 1 January 2009 and (b) any statement of financial position as at a date before 31 December 2009.

The Board expects to issue the amendment in January 2010.

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Discontinued operations

The Board decided that the comment period for the exposure draft (re-exposure of proposals to amend IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) should be 60 days.

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Financial statement presentation

The Board continued its deliberations on the proposals in the discussion paper *Preliminary Views on Financial Statement Presentation*. Specifically, the Board considered:

- segment disclosures (joint meeting agenda paper 7A);
- financial services entity issues (joint meeting agenda paper 7B); and
- costs and benefits (joint meeting agenda paper 7C).

Segment disclosures

The Board continued its discussion from the February 19 joint meeting on possible amendments to IFRS 8 *Operating Segments* to accommodate the core presentation principles of cohesiveness and disaggregation. The Board decided to not make any amendments to IFRS 8 other than the amendments to which they had tentatively agreed at the joint meeting.

Financial services entity issues

The Board considered whether, and if so to what extent, the exposure draft on financial statement presentation should be applied by a financial services entity. The Board agreed that many of its tentative decisions to change proposals in the discussion paper address the concerns expressed by financial services entities. The only tentative decision that the Board specifically discussed that related to a financial services entity is the requirement to present a direct method statement of cash flows. The Board discussed different ways in which a financial services entity might present cash flow information in the financial statements. The Board asked the staff to do more research and outreach on this issue for discussion at a future meeting.

Costs and benefits

The Board was provided with a summary of the information received about the overall costs of the proposed presentation model. In prior meetings, the IASB and the FASB have discussed both the costs and benefits of individual aspects of the proposed presentation model. The boards have made a number of tentative decisions that should reduce the costs of implementing the proposed model but retain its expected benefits. The Board asked the staff to continue its outreach on the changes proposed for preparing a direct method cash flow statement. The Board did not ask for any other cost/benefit information prior to issuing the exposure draft.

Net debt information

The Board continued its discussion on net debt from the September 2009 meeting. In September, the IASB had expressed an interest in presenting information about net debt in the notes to financial statements.

At the January 2010 meeting, the Board tentatively decided to require the analysis of changes in specific line items (all the line items in the debt category, cash, any short-term investments, and finance leases) to be included in a single note disclosure. These line items typically constitute what users of financial statements sometimes refer to as net debt.

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IFRIC Update

The Director of Implementation Activities reported on the IFRIC's meeting on 7 and 8 January 2010. Details of the meeting were published in IFRIC Update, available **here**.

Post-employment benefits

Disclosures

The Board considered proposed disclosures to be included in the forthcoming exposure draft on post-employment benefits. The Board asked the staff to reduce and streamline the disclosures. The Board will consider the revised set of disclosures at a future meeting.

Termination benefits

The Board discussed termination benefits and tentatively decided that:

- the definition of termination benefits should not include benefits provided in exchange for future employee service; and
- an entity should recognise termination benefits when it no longer has the ability to withdraw an offer of those benefits.

The Board expects to publish the final amendments for termination benefits in the first quarter of 2010.

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