IASB Update

From the International Accounting Standards Board

November 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 16 - 18 November 2010.

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

- Asset and liability offsetting
- Conceptual framework
- Emissions trading schemes
- Fair value measurement
- Financial instruments: impairment (education session). Includes Update from 10, 11 & 12 joint board meeting.
- Other comprehensive income
- Revenue recognition

The topics discussed at the IASB Board meeting were:

- Financial instruments: hedge accounting
- IFRS 1 *Removal of fixed dates*
- IFRS Interpretations Committee update
- Liabilities: IFRS to replace IAS 37
- Post-employment benefits
- Technical plan

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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:

1 December
3 December
13-17 December

To see all Board meetings for 2010, 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 factors for offsetting and made the following tentative decisions:

- An entity would be required to offset a recognised financial asset and financial liability if it has the unconditional right of offset and intends to either net settle or settle simultaneously.
- An unconditional right refers to a right of offset that is enforceable in all circumstances (including

default by or bankruptcy of a counterparty).

- Simultaneous settlement refers to realisation of an asset and settlement of a liability at the same moment.

An entity would not be allowed to offset (net) a recognised financial asset and financial liability if the entity has only a conditional right of offset.

Conceptual framework

The IASB and FASB decided that, because of the need to give priority to other projects targeted for completion in June 2011, the Reporting Entity chapter of the Conceptual Framework will not be finalised during the first quarter of 2011, as had been planned previously. In their discussions, the boards reiterated the importance of this chapter; and they indicated that they would like to discuss further the relevance to the project of some fundamental concepts. These would include the circumstances that allow for combined financial statements and the effect of an entity's ownership structure as it applies to, and affects, the usefulness of reported financial information, chiefly equity and net income.

The boards expect to complete this chapter after June 2011.

Emissions trading schemes

The IASB and the FASB discussed accounting issues in a cap and trade scheme. Specifically, the boards discussed the recognition of a liability for emissions in excess of the initial allocation and the measurement of liabilities and purchased allowances. The boards also discussed the presentation of the allowances and liabilities on the statement of financial position.

The staff provided the boards with three views on the recognition of liabilities in a cap and trade scheme. Board members supported two of the views that 'cap' the measurement of the liability for the allocation at the quantity of allowances allocated. Those two views differ only on the timing of the recognition of the liability for excess emissions. Some Board members supported the view that recognises the excess liability throughout the compliance period as an entity emits, while others supported the view that recognises the excess liability when the entity's emissions exceed the liability for the allocation. The boards asked the staff to seek feedback from constituents on both views.

The staff also presented two possible models for measuring the quantity of allowances to be returned or submitted the expected return model and the derecognition model. The boards asked the staff to seek feedback from constituents on both models.

The staff provided two measurement models for measuring the purchased allowances. The boards tentatively decided that purchased allowances should be initially and subsequently measured at fair value. This is consistent with the boards' tentative decision in October 2010 to measure the allocated allowances initially and subsequently at fair value.

The staff provided three views for the presentation of assets and liabilities in a cap and trade scheme in the statement of financial position. The IASB preferred gross presentation of the assets and liabilities on the statement of financial position; but they indicated that they would not object to a linked presentation. (A linked presentation would present the assets and liabilities gross, but the amounts would be presented together and total to a net emission asset or net emission liability.) The FASB tentatively decided that the assets and liabilities should be presented in the balance sheet using a form of linked presentation. However, the FASB also indicated that they did not believe that an entity needed to have the intention of offsetting the assets and liabilities to be able to present the items using a linked presentation.

Next steps

The board asked the staff to perform outreach on the boards' tentative decisions to date and present them with feedback in the second half of 2011.

Fair value measurement

Measuring the fair value of a reporting entity's own equity instruments

The IASB and the FASB tentatively decided that an entity may apply the guidance on measuring the fair value of liabilities when measuring the fair value of its own equity instruments. The boards also tentatively decided to clarify that the objective of measuring the fair value of a liability or an entity's own equity instrument is to estimate an exit price from the perspective of a market participant who holds the corresponding asset at the measurement date, regardless of whether that asset is traded (eg on an exchange).

Measuring the fair value of a group of financial assets and financial liabilities

The boards tentatively decided the following:

- an entity may measure the fair value of financial instruments that are managed on the basis of the entity's net exposure to a particular market risk, or to the credit risk of a particular counterparty, on a net basis if there is evidence that the entity manages its financial instruments in this way. Such evidence includes the following:
- 1. having a documented risk management or investment strategy; and
  2. providing information to management about the entity's net risk exposure resulting from the financial instruments.
- an entity may measure the fair value of financial instruments in this way only if those instruments are measured at fair value in the statement of financial position. An entity may not measure the fair value of its financial instruments on the basis of the entity's net risk exposure if the fair value of those instruments is only required to be disclosed.
- when measuring the fair value of financial instruments on the basis of an entity's net risk exposure, the entity must make an accounting policy decision. That policy must be applied consistently from period to period (ie an entity cannot choose to measure the fair value of its financial instruments on the basis of the entity's net risk exposure in one period and not the next, and it must use a consistent technique to assess its net risk exposure from one period to the next). If an entity makes an accounting policy decision to measure its financial instruments in this way, it must disclose that fact.
- when measuring the fair value of an entity's financial instruments on the basis of the entity's net risk exposure, the objective is to estimate an exit price from the perspective of a market participant who holds that net risk position at the measurement date. When measuring the fair value of the net risk position, an entity should take into account the availability of Level 1 inputs, the timing and legal enforceability of any credit risk mitigants, and the extent to which the underlying market risks associated with the financial instruments are offset.

The boards also tentatively decided to describe common methodologies for allocating bid-ask and credit adjustments to the unit of account but not to require a particular method of allocation. Such allocations should be done on a reasonable and consistent basis.

Premiums and discounts in a fair value measurement

The boards tentatively decided that when measuring the fair value of an asset or liability when a Level 1 input is not available, an entity may apply discounts and premiums only if those discounts or premiums are consistent with the unit of account specified in another standard and if market participants would take into account such discounts or premiums when pricing the asset or liability. If the unit of account is not specified in another standard, an entity should apply discounts and premiums when market participants would do so to maximise the value of the asset or liability on the basis of how they would enter into a transaction for that asset or liability.

Disclosures about fair value measurements

The boards tentatively decided to require an entity to provide the following information about Level 3 fair value measurements:

- a quantitative disclosure of the unobservable inputs and assumptions used in the measurement;
- a description of the valuation control processes in place; and
- a discussion of the sensitivity of the fair value to changes in unobservable inputs and any inter-relationships between those inputs that magnify or mitigate the effect on the measurement.

The boards also tentatively decided to perform further analysis of the operationality of a measurement uncertainty analysis disclosure that provides a range of fair values (exit prices) that could have resulted from the use of other reasonable unobservable inputs in the fair value measurement. Because the boards do not wish to delay the progress and improvements that they have made to develop common fair value measurement standards, the boards will perform this analysis as a separate part of the fair value measurement project to be finalised after completion of their respective standards.

Financial instruments: impairment

Financial instruments: impairment - 10, 11 and 12 November

The boards discussed the outlook period for estimating credit impairment losses, the information to be considered in making those estimates, and the timing of loss recognition.

The boards tentatively decided that an entity should determine expected credit losses on the basis of all available information, including historical data, current economic conditions, and supportable forecasts of future economic conditions. An entity would not assume that future conditions would be the same as current conditions. Additionally, the boards tentatively decided that an entity's estimate of expected credit losses should be based on the lifetime expected losses of the financial asset.

The boards did not make any decisions regarding the timing of loss recognition.

Financial instruments: impairment (education session) - 17 November

The boards continued their discussion of credit impairment. Representatives from the US Office of the Comptroller of the Currency began the meeting by presenting information on loss data for loan portfolios and on other loan performance statistics.

The boards then discussed seven alternative methods that had been briefly discussed at the 10-12 November joint meeting. The boards narrowed the seven alternatives down to the following three, which will be discussed in more detail at a future meeting:

1. Alternative 2: immediate recognition of losses expected to occur in an emergence period shorter than the expected life of the loan (for example the foreseeable future);
2. Alternative 4: recognition of lifetime expected credit losses using a time-proportionate approach combined with a good book and bad book; and
3. Alternative 5: same as alternative 4 but with expected losses allocated using notional sub-portfolios to accommodate 'front loaded' expected loss recognition patterns.

Other comprehensive income

The boards discussed a number of issues raised by constituents who responded to the FASB and IASB exposure drafts. The boards tentatively decided:

- to proceed with the project as originally planned, as opposed to delaying the project until the boards can develop a consistent basis for determining which elements should be presented in Other Comprehensive Income (OCI) and when reclassification to net income is appropriate;

- to require entities to present net income and OCI either in a single continuous statement or in two separate, but consecutive, statements;
- the standards would be effective as of the beginning of a fiscal reporting year that begins after December 15, 2011 for US GAAP and for fiscal reporting years that begin on or after 1 January 2012 for IFRS;
- to affirm the tentative decision to require full-retrospective application for the final standard; and
- to affirm the tentative decision of the FASB to require reclassification adjustments to be presented in both other comprehensive income and net income, and both boards to allow items of other comprehensive income to be presented either net of tax with details in the notes or gross of tax with each item's tax effect displayed parenthetically, and to retain the current calculation of earnings per share based on net income/(profit or loss).

The IASB affirmed its tentative decision to require items of OCI that will be reclassified through profit or loss to be presented separately from items that will not be reclassified through net income.

The FASB affirmed that it will retain the requirement in Topic 220, *Comprehensive Income*, to present the allocation of items of OCI and net income attributable to non-controlling interests separately from those that are attributable to the controlling financial interest holders of a company. This presentation would be in the Continuous Statement of Comprehensive Income or in both statements, depending on whether the two-statement approach is presented.

The boards gave permission for their staff to begin the balloting process for the final standard.

Revenue recognition

The staff provided the IASB and the FASB with a oral update on the feedback that has been received on the exposure draft *Revenue from Contracts with Customers*, which closed for comment on 22 October 2010. In the update, staff summarised the feedback that has been received from the boards' outreach activities and recent roundtable discussions and from the comment letters that the staff have analysed to date.

No decisions were made at this meeting. The boards plan to discuss the feedback received on the exposure draft at their December meeting.

The topics discussed at the IASB meeting were:

Financial instruments: hedge accounting

At this meeting, the IASB continued its discussions of the portfolio hedge accounting model. In particular, the Board discussed portfolio fair value hedge accounting for interest rate risk, often referred to as 'macro-hedging'. (The Board has completed its discussions on the general hedge accounting model and staff are preparing an exposure draft that is expected to be published in December 2010.)

At this session the Board discussed:

- the typical economic interest rate hedging strategy of a bank that hedges interest rate risk on prepayable debt instruments;
- the hedge accounting alternatives available for banks under IAS 39 *Financial Instruments: Recognition and Measurement*;
- the hedge ineffectiveness that arises under the macro fair value hedge accounting model in IAS 39 today; and
- an alternative hedge accounting objective that supports the use of a bottom layer approach for defining the hedged item.

During this session, the Board discussed whether the hedge ineffectiveness that arises under the current macro fair value hedge accounting model is appropriate. The Board noted that the premise of the IAS 39 model is to replicate, on a portfolio basis, the hedge accounting result that would arise on an individual hedged item basis. For this reason, when less than the entire portfolio is hedged, the hedged amount is defined as a proportion of the total portfolio. Given this accounting objective, the Board noted that the ineffectiveness recorded is appropriate.

However, during the outreach activities it was noted that banks tend to hedge on a portfolio basis, to intentionally derive a different hedging result to that which would arise on an individual basis.

The Board discussed whether the new model being developed could accommodate hedging on a portfolio basis where the accounting outcome is different to hedge accounting on an individual basis. Such an approach would characterise hedged cash flows of the portfolio in the bottom layer as less susceptible to prepayment risk than the unhedged cash flows in the top layer.

The Board tentatively decided to consider further the concept of defining the hedged item as a bottom layer of the overall portfolio of prepayable debt instruments.

IFRS 1 Removal of fixed dates

The IASB deliberated the comments received on the exposure draft *Removal of Fixed Dates for First-Time Adopters* (Amendment to IFRS 1) published in August 2010. In order to provide relief for first-time adopters from having to reconstruct transactions, the Board agreed that paragraphs B2 and D20 of IFRS 1 should be amended, to change the fixed dates to the 'date of transition to IFRSs'. The Board also agreed that the amendment should have an effective date of 1 July 2011, with early application permitted.

The Board expects to issue the amendment in December 2010.

IFRS Interpretations Committee update

The IASB received an update from the November 2010 meeting of the IFRS Interpretations Committee. The Board discussed the decision made by the Committee to add the issue of accounting for changes in the carrying amount of a financial liability for a put option, written over shares held by a non-controlling interest shareholder ('NCI put'), in the consolidated financial statements of a parent entity.

Specifically, the Board considered the recommendation of the Committee that it should work with the *Financial Instruments with Characteristics of Equity* (FICE) project team to consider potential alternative models for the accounting for NCI puts. The Board expressed support for the Committee to explore possible solutions to this issue.

Details of the meeting were published in IFRIC Update, available here.

Liabilities: IFRS to replace IAS 37 ***Provisions, Contingent Liabilities and Contingent Assets***

The IASB considered comments received on the recognition criteria proposed in the working draft IFRS that the staff had posted on the IASB's website in February 2010.

The first criterion is that a liability exists. The Board decided tentatively to specify that, in situations of uncertainty, this criterion is met if the available evidence indicates that it is more likely than not that a liability exists. This more-likely-than-not threshold is applied in IAS 37 at present.

The Board also considered requests for more guidance on applying the criterion to liabilities arising in legal proceedings. The Board tentatively concluded that it is more likely than not that an entity defending legal proceedings has a liability if the available evidence indicates that either:

- if the case progresses through the courts, it is more likely than not that the courts will rule against the entity; or

- it is more likely than not that the case will result in an out-of-court settlement.

The Board reviewed a staff draft of application guidance for entities defending legal proceedings. The Board asked the staff to invite interested parties to comment informally on the guidance.

The Board considered objections to its proposal to omit a 'probable outflows' recognition criterion from the IFRS. The Board noted that the probable outflows criterion, which is in IAS 37 at present, prevents entities from recognising some material liabilities in their financial statements. The Board also noted that its other tentative decisions (ie to add a more-likely-than-not threshold to the recognition criteria and to focus guidance for legal proceedings on the expected outcome of the proceedings) might help to address some of the practical difficulties identified by those opposing the omission of the probable outflows criterion. The Board re-affirmed its preference for omitting the criterion but acknowledged the need for further consultation and debate on this matter. The Board asked the staff to prepare, and to invite comments on, a paper setting out the arguments for omitting the probable outflows criterion and discussing the objections raised.

Next steps

The staff intend to place a staff paper - which will address all of the matters discussed above - on the Board's website. The paper will invite interested parties to engage with the staff to help them determine how best to develop the proposals for further consideration by the Board after June 2011. If the Board reaches decisions on all aspects of the proposals, it will expose any proposed revised IFRS in its entirety for further comment.

Post-employment benefits

The IASB discussed the proposals in the exposure draft *Defined Benefit Plans* relating to presentation, disclosure and classification.

Presentation

The Board tentatively decided:

- to confirm the proposals in the exposure draft that an entity should present the service cost and finance cost components in profit or loss;
- not to specify where in profit or loss an entity should present the service cost and finance cost components;
- to permit an entity to present the remeasurements component either in profit or loss or in other comprehensive income (rather than only in other comprehensive income, as the exposure draft had proposed);
- to prohibit subsequent reclassification of the remeasurements component from other comprehensive income to profit or loss;
- to permit, but not require, an entity to transfer within equity the cumulative amounts recognised in other comprehensive income; and
- to confirm the proposals in the exposure draft that an entity should recognise the service cost, finance cost and remeasurements components in the statement of comprehensive income, unless another standard requires or permits their inclusion in the cost of an asset.

Disclosure

The Board tentatively confirmed the disclosure objectives and requirements proposed in the exposure draft, with the following amendments:

- to focus the narrative description of the risks to which the plan exposes the entity on risks that are specific to the entity or unusual, without requiring excessive detail about generic risks;

- to remove the proposals in the ED to disclose:
    1. how the effect of a change to each significant actuarial assumption that was reasonably possible at the beginning of the reporting period would have affected current service cost;
    2. a brief description of the process used to determine demographic actuarial assumptions; and
    3. a narrative discussion of the factors that could cause contributions over the next five years to differ significantly from current service cost over that period.
- to add requirements to disclose:
    1. a narrative description of any funding arrangements and funding policy;
    2. the amount of expected contributions in the next year; and
    3. information about the maturity profile of the benefit obligation.
- to modify the requirement to disaggregate plan assets into categories that distinguish the risk and liquidity characteristics of those assets. The Board tentatively decided to delete the exposure draft's proposed requirement to specify the minimum categories required and instead to provide examples of categories that could be disclosed to meet the principle of the disclosure.
- to replace the proposed requirement to disclose the present value of the defined benefit obligation adjusted to exclude the effect of projected growth in salaries. Instead, there would be a requirement to disaggregate the defined benefit obligation. The Board asked the staff to explore further the basis of such a disaggregation.

Classification

The Board tentatively decided:

- to retain the existing classification of post-employment and other long-term employee benefits. Consequently, the recognition, presentation and disclosure requirements for other long-term employee benefits will remain the same as in IAS 19.
- to clarify that the classification of employee benefits as short-term employee benefits should be on the basis of when the whole amounts resulting from that type of benefit are expected to be settled.
- to clarify that an entity should revisit the classification of a short-term employee benefit if the benefit no longer meets the definition of a short-term employee benefit.

Next steps

In December, the Board intends to discuss among other topics:

- accounting for settlements and curtailments;
- tax and administration costs;
- accounting for risk-sharing features; and
- multi-employer plan disclosures.

Technical plan

The IASB and FASB have amended the timing of several projects to ensure that their main focus is on the more urgent projects on the MoU.

The boards expect to publish an update of the workplan within the next week.

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