

## 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 IASB met in a public meeting from Tuesday 17 May to Thursday 19 May 2011. Most sessions were held jointly with the FASB. Two IASB Board members were able to attend some, but not all, of the sessions. The main focus of the meeting was the four remaining Memorandum of Understanding projects: financial instruments, revenue recognition, leasing and insurance contracts.

The boards are working to develop staff drafts of the revenue recognition and leasing standards that would form the basis for an extended period of drafting review.

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

- Insurance contracts
- IFRS 9: Financial instruments—impairment
- Offsetting financial assets and financial liabilities
- Leases
- Revenue recognition

The topics discussed at the IASB meeting were:

- Annual improvements
- IFRS Interpretations Committee

Other

- Correction—IASB *Update* 11 and 12 May 2011

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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:

31 May-2 June  
13-17 June  
18-22 July

To see all Board meetings for 2011, [click here](#).

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### Podcast summaries

To listen to a short Board meeting audio summary (podcast) of

## IASB/FASB sessions

### Insurance contracts

The IASB and FASB continued their discussion on insurance contracts by considering how risk should be reflected in the measurement of an insurance contract liability.

The IASB tentatively decided that the measurement of an insurance contract should contain an explicit adjustment for risk. The adjustment would be determined independently from the premium and would be re-measured in each reporting period. Eleven of the IASB members present supported this decision. Two voted against.

The FASB tentatively decided that:

- An insurance contract measurement model should use a single margin approach that recognises profit as the insurer satisfies its performance obligation to stand ready to compensate the policyholder in the event of an occurrence of a specified uncertain future event that adversely affects that policyholder.
- An insurer satisfies its performance obligation as it is released from exposure to risk as evidenced by a reduction in the variability of cash outflows.
- An insurer should not remeasure or recalibrate the single margin to recapture previously recognised margin.
- They would consider the inclusion of an onerous contract test as part of the model.

The majority of FASB members supported these decisions.

The IASB and FASB will continue to explore whether the two approaches could be made comparable through disclosures.

#### Next steps

The boards will continue their discussion on this project at their joint meeting on 31 May-1 June 2011.

### IFRS 9: Financial instruments—impairment

The IASB and FASB discussed the impairment project, taking into consideration the feedback received on the supplementary document (SD). The boards considered four alternatives:

1. finalise the approach developed by the IASB on the basis of deliberations before the convergence discussions (ie a time-proportional approach for a 'good book' and full lifetime expected losses for a 'bad book');
2. finalise the approach developed by the FASB based on deliberations before the convergence discussions (ie recognise losses expected to occur in the 'foreseeable future' period);
3. finalise the model in the SD taking into consideration feedback received; or
4. develop a variation of the previous proposals, taking into account the feedback from the boards' original EDs and the SD.

The boards tentatively decided to pursue the fourth alternative. A small working group of board members and senior staff from both the IASB and FASB has been created to develop some specific suggestions, such as baseline models or objectives. This group will develop suggestions to be

presented to the boards within a reasonably short time.

## Offsetting financial assets and financial liabilities

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The IASB and the FASB discussed feedback received on the exposure draft *Offsetting Financial Assets and Financial Liabilities* and instructed the staff to provide analyses of various issues raised by stakeholders for future deliberations, including simultaneous settlement, collateral, and unit of account.

## Leases

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The IASB and the FASB continued their discussion on leases and discussed the following topics: lessee accounting, lessor accounting, contract modifications or changes in circumstances after the date of inception of the lease, reassessment of options in a lease and reassessment of the discount rate in a lease.

### Lessee accounting

The boards tentatively decided that lessees should apply a single accounting approach for all leases consistently with the approach proposed in the Leases exposure draft. This accounting approach would require a lessee to:

- initially recognise a liability to make lease payments and a right-of-use asset, both measured at the present value of the lease payments;
- subsequently measure the liability to make lease payments using the effective interest method; and
- amortise the right-of-use asset on a systematic basis that reflects the pattern of consumption of the expected future economic benefits.

Ten IASB members and five FASB members agreed.

At a future meeting, the boards will consider further:

- the presentation and disclosure of additional information about amortisation of the right of use asset, interest expense on the liability to make lease payments, total lease expense and lease payment cash flows.
- short-term lease accounting. The boards will assess ways to provide relief from some, or all, of the accounting requirements for leases that either have relatively short terms or for which the financing component is not material.

### Lessor accounting

The boards discussed the accounting by lessors under a right-of-use model.

The boards discussed whether there should be one or two approaches to lessor accounting. The boards will continue discussing this issue at a future meeting, at which they will consider the implications of their decision to require a single approach to lessee accounting. The boards requested the staff to provide further analysis at a future meeting that compares the accounting described below with the accounting for lessors that are applying operating lease accounting in existing IFRS and US GAAP.

*Lessor accounting: one approach*

The boards discussed accounting for the underlying asset and the residual asset if there is a single approach to lessor accounting. If a single approach is used, the boards tentatively decided that:

- the lessor would derecognise a portion of the carrying amount of the underlying asset. Twelve IASB members and all FASB members present agreed.
- the lessor would initially measure the residual asset as an allocation of the carrying amount of the underlying asset. All board members present agreed.
- the lessor would subsequently measure the residual asset by accreting the amount of the residual asset over the lease term, using the rate that the lessor charges the lessee. All IASB members present and 5 FASB members agreed.

#### *Lessor accounting: two approaches*

The boards tentatively decided that if there are two approaches to lessor accounting, distinguishing between those two approaches would be based on indicators relating to a definition of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset (all board members present agreed). These indicators would:

- include a 'fair value indicator' (12 IASB members and 4 FASB members agreed);
- include a 'variable rent indicator' (all IASB members present and 5 FASB members agreed);  
and
- not include an 'embedded or integral services indicator' (13 IASB members and 4 FASB members agreed).

The boards discussed the accounting for the underlying asset and the residual asset if there are two approaches to lessor accounting. If substantially all of the risks and rewards of ownership of the underlying asset are transferred to the lessee and the lessor does not apply operating lease accounting in existing IFRS and US GAAP, the boards indicated a preference that the lessor would:

- derecognise the entire carrying amount of the underlying asset. All board members present agreed.
- initially measure the residual asset at the present value of the estimated value of the underlying asset at the end of the lease term, discounted using the rate that the lessor charges the lessee. All board members present agreed.
- subsequently measure the residual asset by accreting the amount of the residual asset over the lease term using the rate the lessor charges the lessee. All IASB members present and five FASB members agreed.

#### *Accounting for the right to receive lease payments*

The boards indicated a tentative preference for measuring a lessor's right to receive lease payments in accordance with the requirements for other similar financial assets. The boards nevertheless requested the staff to analyse whether this would create any unintended consequences, specifically if the boards were to specify two approaches for lessor accounting. Presentation of the lessor's right to receive lease payments and the residual asset

The boards tentatively decided that a lessor should present its right to receive lease payments separately from any residual asset. The boards will discuss the presentation of the residual asset at a future meeting. Seven IASB members and all FASB members present agreed.

Contract modifications or changes in circumstances after the date of inception of the lease

The boards tentatively decided to provide guidance on accounting for changes after the date of inception of the lease as follows:

- A modification to the contractual terms of a contract that is a substantive change to the existing contract should result in the modified contract being accounted for as a new contract. The change is a substantive change if it results in a different determination of whether the contract is, or contains, a lease or, if applicable, whether the contract transfers substantially all of the risks and rewards incidental to ownership of the underlying asset.
- A change in circumstances other than a modification to the contractual terms of the contract that would affect the assessment of whether a contract is, or contains, a lease should result in a reassessment as to whether the contract is, or contains, a lease.
- A change in circumstances other than a modification to the contractual terms of the contract that would affect whether a lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset should not result in a reassessment or a change in the accounting approach.

All board members present agreed.

#### Reassessment of options in a lease

The boards discussed how lessees and lessors should reassess whether a lessee has a significant economic incentive to exercise:

- an option to extend or terminate a lease, and
- an option to purchase the underlying asset.

The boards tentatively decided that a lessee and a lessor should consider contract-based, asset-based and entity-based factors in reassessing whether a lessee has a significant economic incentive to exercise an option. The boards noted that all these factors should be considered together and the existence of only one factor does not necessarily, by itself, signify a significant economic incentive to exercise the option. Eight IASB members and five FASB members agreed.

The boards tentatively decided that the thresholds for evaluating a lessee's economic incentive to exercise options to extend or terminate a lease and options to purchase the underlying asset should be the same for both initial and subsequent evaluation, except that a lessee and lessor should not consider changes in market rates after lease commencement when evaluating whether a lessee has a significant economic incentive to exercise an option. All board members present agreed.

The boards tentatively decided that changes in lease payments that is due to a reassessment in the lease term should result in:

- a lessee adjusting its obligation to make lease payments and its right-of-use asset; and
- a lessor adjusting its right to receive lease payments and any residual asset, and recognising any corresponding profit or loss (pending the boards' decision on lessor accounting).

All board members present agreed.

#### Reassessment of the discount rate

The boards discussed whether there are circumstances that would require a lessee or a lessor to reassess the discount rate that is used to measure the present value of lease payments.

The boards tentatively decided that the discount rate should not be reassessed if there is no change in the lease payments.

All board members present agreed.

The boards tentatively decided that the discount rate should be reassessed when the changes below are not reflected in the initial measurement of the discount rate:

- when there is a change in lease payments that is due to a change in the assessment of whether the lessee has a significant economic incentive to exercise an option to extend a lease or to purchase the underlying asset. Nine IASB members and all FASB members present agreed.
- when there is a change in lease payments that is due to the exercise of an option that the lessee did not have a significant economic incentive to exercise. Ten IASB members and all FASB members present agreed.

The boards also decided that a lessee or lessor should determine a revised discount rate using the spot rate at the reassessment date and should then apply that rate to the remaining lease payments (ie to the remaining payments due in the initial lease plus the payments due during the extension period or upon exercise of a purchase option).

All board members present agreed.

## Revenue recognition

The IASB and the FASB continued their deliberations on the revenue recognition project by discussing the presentation and disclosure requirements for an entity's contracts with customers, disclosures about assets from contract acquisition or fulfilment costs, impairment and amortisation of assets from contract acquisition or fulfilment costs, recognition of an asset from contract acquisition costs, and onerous contracts.

### Presentation and disclosures of contracts with customers

The boards tentatively decided to retain the presentation and disclosure requirements that were proposed in the exposure draft *Revenue from Contracts with Customers* with the following amendments and clarifications.

### Presentation of contract assets and contract liabilities

The boards clarified that an entity could use labels other than 'contract asset' and 'contract liability' to describe those assets and liabilities in the financial statements. However, an entity should disclose sufficient information to enable users of the financial statements to clearly distinguish between unconditional rights to consideration (a receivable whether billed or unbilled) and conditional rights to consideration (ie a contract asset).

All members of both boards that were present supported that clarification.

### Disaggregation of revenue

The boards tentatively decided that:

- the revenue standard should not prescribe the specific categories into which an entity should disaggregate revenue. Instead, the standard should provide a clear disaggregation principle and examples of categories that may be appropriate. That decision was supported by twelve members of the IASB and all members of the FASB.

- an entity should disaggregate revenue in the statement of comprehensive income or in the notes to the financial statements. That clarification was supported by all the IASB members present and by six FASB members.
- an entity would not be required to also disaggregate the impairment loss allowance (for customers' credit risk that is presented adjacent to revenue). That clarification was supported by twelve members of the IASB and four members of the FASB.

#### Reconciliation of contract assets and contract liabilities

The boards clarified that an entity should include additional line items in the reconciliation of contract assets and contract liabilities if those additional reconciling items would be needed for understanding the change in the balance of a contract asset or contract liability. The boards also tentatively decided that an entity does not need to include specified line items in the reconciliation if those reconciling items would not be useful for explaining a material change in that contract asset or contract liability balance. All board members present agreed with that clarification.

#### Disclosure of remaining performance obligations

The boards tentatively decided that:

- an entity should disclose the amount of the transaction price that is allocated to remaining performance obligations for contracts that have both of the following attributes:
  - an original expected contract duration of more than one year; and
  - terms and conditions that result in the entity, in practice, being required to apply each step of the revenue model (specifically, to determine the transaction price and to allocate that transaction price to the separate performance obligations) in order to recognise revenue. An entity would not be required to provide this disclosure if, in practice, the entity would not need to specifically apply those steps of the revenue model to recognise revenue (eg for some 'time and materials' contracts).
- an entity should explain when it expects those amounts to be recognised as revenue, either on a quantitative basis in time bands that would be most appropriate for the duration of the contract or by using a mixture of quantitative and qualitative information.

All FASB members and nine IASB members agreed with those decisions.

#### Disclosures about assets from contract acquisition or fulfilment costs

The boards tentatively decided that an entity should disclose, for each reporting period, a reconciliation of the carrying amount of an asset arising from the costs to acquire or fulfil a contract with a customer, by major classification (eg acquisition costs, precontract costs, and setup costs), at the beginning and end of the period, separately showing:

- additions
- amortisation
- impairments
- impairment losses reversed (under IFRSs only, not applicable in US GAAP).

In addition, the boards tentatively decided that an entity should provide the following qualitative disclosures:

- a description of the method used to determine the amortisation for the period

- for impairment losses reversed under IFRSs, the circumstances that led to the reversal of the impairment loss.

Eleven members of the IASB and five members of the FASB agreed with those decisions.

#### Impairment of assets arising from contract acquisition or fulfilment costs

The boards tentatively decided that an entity should recognise an impairment loss to the extent that the carrying amount of the asset exceeds (a) the amount of consideration to which the entity expects to be entitled in exchange for the goods or services to which the asset relates, less (b) the remaining costs that relate directly to providing those goods or services. To determine the amount to which an entity expects to be entitled, an entity should use the principles for determining the transaction price. For IFRSs, reversals of previous impairments are required when the impairment condition ceases to exist. For US GAAP, reversals of previous impairments are prohibited. All of the board members present agreed with the decision.

**Amortisation of assets arising from contract acquisition or fulfilment costs** The boards tentatively decided to retain the proposal in the exposure draft that would require an entity to amortise the asset on a systematic basis consistent with the pattern of transfer of goods or services to which the asset relates. The boards clarified that the asset might relate to goods or services to be provided under future contracts with the same customer (eg renewal options). Eight members of the IASB and six members of the FASB agreed with those decisions.

**Recognition of an asset from contract acquisition costs** As a practical expedient, the boards tentatively decided that for contracts with a duration of one year or less, an entity should be permitted to recognise contract acquisition costs as an expense when incurred. Eleven members of the IASB and six members of the FASB agreed with that decision.

#### Onerous contracts

The boards tentatively decided to limit the application of the onerous test to performance obligations that an entity satisfies over time (eg long-term service contracts).

In addition, the boards tentatively decided that the costs that an entity should consider when applying the onerous test are the lower of:

- the costs that relate directly to satisfying the performance obligation (defined in paragraph 58 of the exposure draft); and
- any amounts that the entity would have to pay to cancel the contract.

All board members present agreed with those decisions.

#### Next steps

In June 2011, the boards plan to discuss the following topics:

- transition and effective date; and
- application of the revenue model to some industries (eg the telecommunications industry).

## IASB sessions

### Annual improvements



Assessment of proposed improvements for the 2009-2011 cycle against the new criteria for inclusion within Annual Improvements

The IASB decided that the issues that they had approved for inclusion within Annual Improvements at earlier meetings met the new criteria approved by the trustees in February 2011. The proposed amendments relate to:

- IFRS 1: clarification of the borrowing costs exemption;
- IAS 1: clarification of requirements for comparative information;
- IAS 1: enhanced consistency with the *Conceptual Framework* published in September 2010;
- IAS 16: classification of servicing equipment;
- IAS 32: accounting for the income tax consequences of distributions; and
- IAS 34: reporting segment information for total assets in interim reports.

The Board tentatively agreed with a 90-day comment period for the exposure draft *Improvements to IFRSs* which should be published in June 2011.

The Board will consult with the Trustee Due Process Oversight Committee before finalising this comment period, because it is shorter than the standard 120 days.

Issues not recommended for inclusion within the Annual Improvements cycle for 2010-2012

Following the IFRS Interpretations Committee's recommendations, the Board agreed that the five issues listed below did not meet the criteria for inclusion in Annual Improvements:

- IFRS 3: hedging the foreign exchange risk in a business combination;
- IFRS 3: settlement of a pre-existing relationship between the acquirer and the acquiree;
- IAS 8: hierarchy of guidance to select an accounting policy;
- IAS 36: accounting for impairment testing of goodwill when non-controlling interests are recognised; and
- IAS 41: Illustrative Examples-presentation of revenue in the profit or loss account.

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## IFRS Interpretations Committee

The IASB received an update from the May 2011 meeting of the IFRS Interpretations Committee. Details of the meeting were published in IFRIC Update, which is available by [clicking here](#).

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## Correction—IASB *Update* 11 and 12 May 2011

In the summary of the hedge accounting decisions in the 11 and 12 May 2011 edition of IASB *Update* the decision summary referred to hedged items when it should have referred to hedging instruments. The corrected decision summary is in the hedge accounting section of the May IASB *Update*—please [click here](#).

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